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COMPANY LAW

*V Sudesh**

I INTRODUCTION

IN THIS annual survey of company law all the important cases decided by the Supreme Court of India, the high courts and the Company Law Board have been surveyed under different headings of the Companies Act, 1956. Judgments of the courts, which are considered landmark during the year and those, which have clarified the law on a particular issue have only been discussed.

II PRELIMINARY ISSUES

Unincorporated company

In *Jai Narain Parasrampuria (Dead)* v. *Pushpa Devi Saraf*[1] the Supreme Court had an occasion to comment and clarify on the interests of the promoters *vis-a-vis* an unincorporated company and also on the applicability of the doctrine of corporate veil. The court held that the Indian law on unincorporated corporation becoming owner of property differed from the English common law. Under the common law an unincorporated corporation could not have become an owner of the property. In India section 5 of the Transfer of Property Act provides for transfer in favour of the company which is unincorporated. The court said that once the company upon incorporation accepts the contract to purchase property and communicates such acceptance to the other party, the fact that such an acquisition of property by the company doesn't find place in the articles of association of the company is of no relevance. If the purchase of the property is for the purpose of the company and it is not *ultra vires* the purpose for which the company had been incorporated, the title over the property passes to the company.

Lifting the corporate veil

In *Jai Narain Parasrampuria (Dead)* v. *Pushpa Devi Saraf*[2] the Supreme Court applied the doctrine of corporate veil and observed that when the promoters/directors were using the personality of the company to further their

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1 (2006) 7 SCC 756.

2 (2006) 7 SCC 756.

personal object by denying title of the company over the property purchased by the unincorporated company and setting up their own title, it was a fit case for applicability of the doctrine of lifting the corporate veil.

In *Mrs. Premlata Bhatia* v. *Union of India*,[3] it was held that the doctrine of lifting of corporate veil cannot be allowed to be employed by persons to take advantage of their own wrong. The court opined that hey have permitted lifting of corporate veil to reveal the 'true' identity of the company and to expose those persons who sought to use the cloak of corporate personality to hide and shun such exposure with a view to 'defeat public convenience, justify wrong , protect fraud, or defend crime'.

III COMPANY LAW BOARD

Necessary party

In *A. Vellayan* v. *Cynosure Investment (P) Ltd.*,[4] the Company Law Board laid down the three essential requirements for a necessary party as follows:

(i) A necessary party is one without whom no order can be made effectively.
(ii) A proper party is one in whose absence, an effective order can be made, but whose presence is necessary for a complete and final decision on the question involved in the proceeding.
(iii) A party must be directly or legally interested in the subject matter of the litigation, i.e. he can say that the litigation may lead to a result, which will affect him legally that is by curtailing his legal rights.

IV INCORPORATION OF COMPANY AND MATTERS INCIDENTAL THERETO

Change in name of company

In *Prasad Technology Park Pvt. Ltd* v. *Sub-Registrar & Others*,[5] the appellant, "Prasad Garments Pvt. Ltd." was a registered company under the Companies Act. On or about 5.3.1999 it entered into a lease cum sale agreement with the third respondent herein upon payment of premium of a sum of Rs.14,49,453, which amounted to 99 percent of the tentative cost of the land and one yearly rent of Rs. 966 for a period of 11 years computed from 25.6.1997. The name of the said company, however, was changed to "Prasad Technology Park Pvt. Ltd." The appellant presented the said instrument for registration before the first respondent herein on a stamp duty of Rs.100. The first respondent, however, was of the opinion that the stamp duty on the total

3 (2006) 3 Comp LJ 193 (Del).
4 (2006) 2 Comp LJ 272 (CLB).
5 AIR 2006 SC 604.

amount of the original lease deed as mentioned in the lease deed dated 5.3.1999 was required to be paid. In response to this demand the appellant contended that the supplementary agreement (consequent to change of name) was merely a deed of rectification. The issue before the court was whether execution of a supplementary agreement entered into by and between the appellant and the third respondent herein would amount to a transfer so as to attract stamp duty payable in terms of the schedule appended to the Karnataka Stamps Act, 1957, consequent upon the change of name of the erstwhile company to the appellant company?

The Supreme Court held that only because the name of the company was changed, the same would not mean a fresh transaction took place. Having regard to the change in the name of the company, the appellant's name was sought to be substituted in the original agreement. The period of the lease, the quantum of the premium paid and other terms and conditions remained unaltered except the restriction on nature of use was removed. By reason of mere change of user from carrying on one business to another, it is trite that a fresh transaction does not take place. The terms and conditions of the lease can be changed by mutual consent of both the parties. Unless the essential agreements thereof as contained in section 105 of the Transfer of Property Act are altered, it cannot be said that the parties to the contract entered into a fresh transaction.

Form of contracts – sections 46 and 48

In *Panchanan Dhara* v. *Monmatha Nath Maity (dead) through LRS,*[6] the company refused to execute a sale deed in favour of respondent no. 1 on several grounds. One of the grounds was that the agreement for sale was not enforceable as the provisions of sections 46 and 48 of the Companies Act had not been complied with. Commenting on the procedure prescribed under section 46 of the Act, the Supreme Court held that, section 46 of the Companies Act merely lays down the mode of signing the contract on behalf of the company. Once a deed is executed on behalf of the company, it is the company and not the persons signing who can sue or be sued on the contract if the evidence is clear that the signature was only that of the company.

In the instant case the contract was executed in the name of the company and all the five directors executed the agreement. Thus, the court held that even in the absence of a resolution by the company the contract could not have been held to be invalid or illegal.

As regards putting the seal of the company (section 48), the court commented that, it is a relic of the days when medieval barons, who could not read or write, used their rings to make a characteristic impress. Even in the absence of a seal, the company may still be held to be liable having regard to the nature of the transaction and the authority of those who had executed it. If the act of the directors is not *ultra vires* or no public policy is involved, the parties acting thereupon cannot be left at large.

6 (2006) 5 SCC 340.

V SHARE CAPITAL AND DEBENTURES

Whether section 108 of the Companies Act is mandatory or not?[7]

The Supreme Court in *M/s Dove Investments Pvt. Ltd.* v. *M/s. Gujarat Industrial Inv. Corporaion*[8] held that whether the statute would be directory or mandatory would depend upon the scheme thereof. Ordinarily, a procedural provision would not be mandatory even if the word 'shall' is employed therein unless a prejudice is caused.

Board of Directors' power to ratify decision taken by managing director

In *Maharashtra State Mining Corporation* v. *Sunil*,[9] the Supreme Court has held that while it is right to hold an act by a legally incompetent authority invalid, it is entirely wrong to hold that such an invalid act cannot be subsequently rectified by ratification of the competent authority. Ratification by definition means making valid an act already done. The principle is derived from the Latin phrase *ratihabito mandato aequiparatur*, namely, "a subsequent ratification of an act is equivalent to a prior authority to perform such act". Therefore, the court said that ratification assumes an invalid act, which is retrospectively validated. Similarly, in *B.M. Varma* v. *State of UP and Ors,*[10] the High Court of Allahabad held that the court cannot interfere in the removal of a managing director, whence the removal is done in accordance with the law, duly ratified by board of directors under articles of the company. Further, the court viewed that it may interfere, if the action had some public law character attached to it.

VI WINDING UP PROCEEDINGS

Proof and ranking of claims in winding up - interpretation of sections 529 and 529-A of the Companies Act

During winding up of a company there are several claims that have to be settled. On the one hand the interests of the secured creditors have to be taken care of and on the other the wages and other dues of the workmen have to be met. These requirements are adequately taken care of by sections 529 and 529-A of the Companies Act, 1956. The Supreme Court in *ICICI Bank Ltd.* v.

7 S. 108 (1) prohibits registration of transfer of shares except on production of the instrument of transfer and unless the conditions precedent are complied with.
S. 108 (1A) provides that every instrument of transfer of shares shall be in such form as may be prescribed, and shall, before it is signed by the transferor, be presented to the prescribed authority for the purpose of stamping or otherwise thereon the date on which it is so presented and after it is so executed by the transferor and the transferee and completed in all other respects be delivered to the company within two months from date of such presentation.
S. 108 (1D) provides that the central government has been conferred with the power to extend the period mentioned in those sub-sections as it may deem fit, if it is of the opinion that it is necessary to do so to avoid hardship in any case.

8 AIR 2006 SC 1454.

9 (2006) 5 SCC 96.

10 (2006) 3 Comp LJ 150 (All).

SIDCO Leaher Ltd. & Ors,[11] had an occasion to interpret these sections[12] of the Act. The court held that under section 529, as it stood prior to its amendment, the dues of the workmen were not treated *pari passu* with the secured creditors as a result whereof innumerable instances came to the notice of the court that the workers may not get anything after discharging the debts of the secured creditors. It was only with a view to bring the workmen's dues *pari passu* with the secured creditors, that section 529-A was enacted. The court further observed that, section 529-A, no doubt contains a *non-obstante* clause but in construing the provisions thereof, it was necessary to determine the purpose and object for which the same was enacted. The *non-obstante* nature of a provision although may be of wide amplitude, the interpretative process thereof must be kept confined to the legislative policy. Only because the dues of the workmen and the debt due to the secured creditors are treated *pari passu* with each other, the same by itself would not lead to the conclusion that the concept of *inter se* priorities amongst the secured creditors had thereby been intended to be given a total go by. Further, the court held that section 529-A does not *ex facie* contain a provision (on the aspect of priority) amongst the secured creditors and, hence, it would not be proper to read there into things, which the Parliament did not comprehend. The provisions of the Companies Act may be a special statute but if the special statute does not contain any specific provision dealing with the contractual and other statutory rights between different kinds of the secured creditors, the specific provisions contained in the general statute shall prevail. In fact the court held that *Allahabad Bank* v. *Canara Bank & Anr*[13] is not an authority for the proposition that in terms of section 529-A the distinction between two classes of secured creditors does no longer survive.

Role of official liquidator in winding up proceedings

The Supreme Court in *Rajasthan Financial Corporation & Another* v. *Official Liquidator & Another*[14] gave due importance to the role of official liquidator in winding up proceedings and virtually laid down that without the notice of the official liquidator no action for recovery of debt can be initiated by any tribunal or court. In this case appellant no. 1, i.e., the Rajasthan Financial Corporation, a corporation constituted under section 3 of the State Financial Corporations Act, 1951 (SFC Act) and appellant no. 2, the Rajasthan

11 AIR 2006 SC 2088.

12 S. 529A: Notwithstanding anything contained in any other provision of this Act or any other law for the time being in force, in the winding up of a company-
(a) workmen's dues; and
(b) debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to sub-section (1) of section 529 pari passu with such dues, shall be paid in priority to all other debts.
(2) The debts payable under clause (a) and clause (b) of sub-section (1) shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

13 AIR 2000 SC 1535.

14 AIR 2006 SC 755.

State Industrial Development and Investment Corporation Limited, a deemed financial corporation are the secured creditors of M/s. Vikas Woolen Mills Ltd, the company-in-liquidation. The company was ordered to be wound up and the official liquidator was directed to take charge of the assets of the company-in-liquidation by the High Court of Bombay. The official liquidator applied for directions to the company court and sought permission to get the property valued by a valuer from the panel of valuers of the official liquidator, and to sell the properties by public auction. Further he sought the issue of a direction to the appellants, the secured creditors, to advance Rs. 25,000 each to the official liquidator to meet the expenses for selling the assets of the company-in-liquidation on condition that the amount would be reimbursed to the appellants on priority basis from the sale proceeds. The information about the filing of this application was conveyed by the official liquidator to the appellants. Apparently the appellants had no notice of the proceedings in liquidation and they, as secured creditors, submitted that they want to stand outside the winding up proceedings and in their reply to the official liquidator, indicated that they have proposed to pursue the remedies available to them under section 29 of the SFC Act. In addition to opposing the report of the official liquidator, the appellants also filed an application praying that as secured creditors stand outside the winding up, they may be permitted to realize the securities and apportion the net sale proceeds between them and Bank of Baroda, another secured creditor. The company court rejected their application and took the view that the right available under section 29 of the SFC Act had to be exercised consistently with the right of the workmen represented by the official liquidator who was a charge holder and ranked *pari passu* with the secured creditors, even if they stood outside winding up.

The issue before the Supreme Court was whether the official liquidator representing a ranked secured creditor working under the control of the company court can be kept out of the process of recovery of debt by the recovery officer appointed by the debt recovery tribunal?

The court examined sections 529 (1) (c)[15] and 529-A of the Companies Act and was of the opinion that there is no conflict on the question of the applicability of the above sections to cases where the debtor is a company and

15 S. 529 (1)(c): the respective rights of secured and unsecured creditors, as are in force for the time being under the law of insolvency with respect to the estates of persons adjudged insolvent:
[Provided that the security of every secured creditor shall be deemed to be subject to a pari passu charge in favour of the workmen to the extent of the workmen's portion therein, and, where a secured creditor, instead of relinquishing his security and proving his debt, opts to realise his security,-
(a) the liquidator shall be entitled to represent the workmen and enforce such charge;
(b) any amount realised by the liquidator by way of enforcement of, such charge shall be applied rateably for the discharge of workmen's dues; and
(c) so much of the debt due to such secured creditor as could not be realised by him by virtue of the foregoing provisions of this proviso or the amount of the workmen's portion in his security, whichever is less, shall rank *pari passu* with the workmen's dues for the purposes of section 529A.]

is in liquidation. The court observed that the conflict, if any, is in the view that the debts recovery tribunal could sell the properties of the company in terms of the Recovery of Debts Act. The court after discussing the issues at length, laid down the following principles:

1. A debt recovery tribunal acting under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 would be entitled to order the sale and to sell the properties of the debtor, even of a company-in-liquidation, through its recovery officer but only after notice to the official liquidator or the liquidator appointed by the company court and after hearing him.
2. A district court entertaining an application under section 31 of the SFC Act will have power to order sale of the assets of a borrower company-in-liquidation, but only after notice to the official liquidator or the liquidator appointed by the company court and after hearing him.
3. If a financial corporation acting under section 29 of the SFC Act seeks to sell or otherwise transfer the assets of a debtor company-in-liquidation, the said power could be exercised by it only after obtaining the appropriate permission from the company court and acting in terms of the directions issued by that court as regards associating the official liquidator with the sale, the fixing of the upset price or the reserve price, confirmation of the sale, holding of the sale proceeds and the distribution thereof among the creditors in terms of section 529-A and section 529 of the Companies Act.
4. In a case where proceedings under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 or the SFC Act are not set in motion, the concerned creditor is to approach the company court for appropriate directions regarding the realization of its securities consistent with the relevant provisions of the Companies Act regarding distribution of the assets of the company-in-liquidation.

Company in liquidation - fastening liability on a third party corporation

In *Punjab State Industrial Development Corporation Ltd.* v. *PNFC Karamchari Sangh*,[16] the question was, whether the liability with respect to money due from a company in liquidation towards its workers could be fastened on an independent corporation. In the instant case M/s Punjab National Fertlizer and Chemical (PNFC) is a company limited by shares and is a registered company under the Companies Act, 1956. This company was promoted by the Punjab State Industrial Development Corporation Limited (PSIDC) and it held 43.23 percent shares in PNFC. On recommendation of the BIFR the PNFC was ordered to be wound up. Meanwhile the PNFC had stopped

16 (2006) 4 SCC 367.

paying wages to its workers, who approached the chief minister for relief. The CM asked the finance department to permit the PSIDC to raise resources by market borrowing in order to pay six months salary to the workers. The workers filed an application before the company judge on the basis of the note made by the CM terming it as order of the CM. On the said application of the workers the company judge passed an order directing PSIDC to release funds in terms of the order of the CM.

The PSIDC applied for review of the said order of the company judge on grounds that it was not in a sound financial position to make the payment and secondly it was not liable to pay since the workers who were to be paid were not the workers of PSIDC; and the interest of the workers was in any case protected because the workers' dues were the first charge on the sale proceeds of the assests of the company in view of section 529-A of the Companies Act. On the review application and the appeal against the review being dismissed, the Supreme Court, allowing the appeal held that, under section 446 of the Companies Act, the powers of the company judge under liquidation might be wide, but that did not empower him to pass an order making a distinct and separate corporation, a third party, liable for the liabilities of the company in liquidation.

In *Kamal Kumar Dutta and Another* v. *Ruby General Hospital Ltd.*,[17] the Supreme Court laid down the following propositions of law:

1. After the amendment of the Companies Act, 1956 w.e.f 31.5.1991 the power under sections 397 and 398 is being exercised by the Company Law Board (CLB) under section 10-E of the Act. Appeal against the order passed by CLB lies to the high court under section 10-F of the Act. No further appeal is provided against the order passed by the single judge. The Letters Patent appeal has been taken away by the Parliament while amending section 100-A of CPC.
2. Under sections 397 and 398 it is not necessary that in every case the relief of winding up should be made. It is an option with the tribunal if it considers that in order to bring an end to the matters complained of, it can pass orders for winding up if it is just and equitable or it can pass such orders as it thinks fit. The acts which would amount to oppression to the members or mismanagement or material alteration in the control of the company or prejudice to the interest of the company would depend upon the facts and circumstances of each case.
3. If a board meeting had been convened without proper service of notice to the appellants then such meeting cannot be said to be valid and the material change brought about in the management to the detriment of the interest of the main promoter is squarely covered under section 398 (1) (b) of the Act.

17 (2006) 7 SCC 613.

Evidence required for seeking winding up

In *V J Brij Fiscal Services (P) Ltd., Ujjain* v. *Primus Chemicals Ltd., Ujjain,*[18] the petitioner sought winding up of the respondent company on the ground that it was unable to pay debts. There was no evidence in support of the averment made that legal notice was served on the respondent company. The High Court of Madhya Pradesh held that in the absence of such evidence, which alone is material for maintaining the petition, the petition was not maintainable.