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Taxmann – Webinar

Year in Review – Corporate Law Judgments That Shaped 2024

Presentation by Gaurav N Pingle

WHY READ & STUDY JUDGMENTS

- Important from perspective of consulting
- Important from perspective of record keeping
- Decision making is backed – up by Court judgments
- Awareness in compliance of Companies Act & related laws
- Helpful in drafting Legal Opinions
- Helpful in litigation cases
- Study and Application of Principles of Interpretation of Statutes
- **Value Addition to client in true sense**

FEW IMP. DISCLAIMERS

- Academic discussion only
- Brief discussion on the prominent orders only
- No conflict of interest with any party in any case discussed
- Some orders / judgments may be appealed
- Facts of the case are IMP, refer judgment for more detailed facts

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Power to freeze the shares in demat A/c – by NSDL, BSE, NSE

Who is a promoter – his role in co.

Relevance of this judgment in interpreting 'Promoter' for listed & unlisted Cos.

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Dr. Pradeep Mehta v. Union of India
[2024] 165 taxmann.com 780 (Bombay)

- Interpretation of the term 'Promoter'
- Powers of SEBI to freeze shares in demat account
- Powers of SEBI under SEBI Act vis-à-vis SEBI LODR Regulations & Circulars issued

6 NOT ABLE TO PROVE ACTIVE ROLE OF PETITIONER AS 'PROMOTER'

- Co. was formed in the year 1989, and after all statutory compliances, it was listed on BSE. There is nothing on record that the petitioner did not cease to have any role, after the company was formed and/or till it defaulted under the said Regulation although it was managed by BoD.
- None of the Respondents have showed any active role of the petitioner in the capacity of the promoter, in the management of the company and any role and obligation factually fastened on the petitioner in the various compliance which are required to be undertaken under SEBI (LODR) Regulations, at the time of the freezing of his demat accounts.
- It is difficult to accept that the listing obligations as postulated under the SEBI (LODR) Regulations were at all applicable qua the petitioner, so as to apply regulation 98(1)(c) in freezing the demat account of the petitioner.

7 ANNUAL RETURN NOT VERIFIED FOR 'PROMOTER' OF CO.

- In the circumstances in hand when a basic obligation under the regulations itself is not conferred on the promoter of the nature petitioner is, there could not have been a corresponding duty and a consequent default, attributable for any action to be taken under Reg. 98.
- Sec. 92 of Cos. Act provides for filing of the annual return. Thus, assuming that the SEBI/BSE/NSE intends to justify its action to take the petitioner as the promoter, it has to look into the last annual return filed by Co. and its declaration qua the promoters as per the requirement of section 92(1)(e);
- It cannot take a recourse to what was the position when the company was formed, i.e., in the year 1989;
- It was necessary for the SEBI/NSDL to look into the last return as filed by the company which in the instant case would be of the years 2014 to 2016 which is of the period just prior to the default by Co.;

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BASIC PRINCIPLE OF NATURAL JUSTICE NOT FOLLOWED – NO SHOW CAUSE / NO PRIOR OPPORTUNITY

An action to freeze the petitioner's demat account is an action entailing drastic civil consequences.

The shares are the property of the petitioner. Any coercive action in respect of one's property is required to be taken in accordance with law and after complying with the basic principles of natural justice.

No show cause notice or a prior opportunity of a hearing was granted to the petitioner – Freezing not only the petitioner's shares in said Co. but also the other shareholdings in ITC Ltd. For such reason also, the impugned action on the part of NSDL is required to be held to be brazenly illegal, unreasonable and arbitrary.

9 POWER TO FREEZE DEMAT A/C – SEBI (LODR) REGULATIONS VIS-À-VIS SEBI ACT

- SEBI (LODR) Regulations do not confer any power with SEBI to issue a circular to freeze the demat a/c and shareholdings of Promoters which he would possess in respect of the shares held by him of cos. other than the defaulting Co. of which he was a Promoter.
- For any such action to be recognized under the Circular dated 26-10-2016, such power to freeze the demat account is required to be traced in the substantive law, namely, under the SEBI Act.

SEBI CIRCULAR – SEBI REGULATIONS – SEBI ACT

- Even assuming that there is some power in the Regulations, the Regulations cannot override the substantive provisions of law and/or have any provision which itself is not recognized by the substantive law i.e. SEBI Act.
- The position in respect of a circular would be still worse, as the circular cannot provide anything which is not provided in the substantive law and the regulations

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Conversion of Company Limited by shares into Company Limited by Guarantee – nothing prescribed in Rules.

Whether such 'conversion' falls under 'arrangement' under the Companies Act, 2013.

Can Sec. 8 Cos. Take advantage of this precedent

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IN THE MATTER OF AZIMPREMJI TRUST SERVICES PVT. LTD.

C.P. (CAA) NO. 52/BB/2022 – SEPTEMBER 4, 2022. NCLT, BENGALURU BENCH

- *Brief Facts:* Petition was filed u/s 230 of the Companies Act read with Sec. 18 and Sec. 66 of the Companies Act along with Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 inter alia seeking for the sanction of Scheme of Azim Premji Trust Services Private Limited and their respective shareholders – Petitioner had filed a scheme to convert the Co. into a Co. limited by guarantee without share capital.

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Conversion of Co. – Ltd. by shares into Co. Ltd. by Guarantee

- *No rules have been prescribed so far for allowing the conversion in the reverse direction, from the Company limited by shares into a company limited by guarantee*
- *Merely because the rules have not yet been notified for the conversion of the company limited by shares into a company limited by guarantee, it does not mean that such conversion cannot be allowed when it is allowable under the provisions of Section 18 of Companies Act, 2013.*

Such conversion is covered in 'Arrangement'

- *This is essentially covered within the scope of 'arrangement' between the company and its members, and under Section 2(21) of the Act, such company limited by guarantee prescribed for an undertaking to be given by the members to contribute to the assets of the Company in the event of its being wound up.*
- *Section 4 (1) (d) (ii) of the Act also prescribes as to what was to be mentioned in the Memorandum of the company related to the guarantee undertaken by the members in respect of the company limited by guarantee.*

Buy back of shares vs capital reduction

Interpretation of provisions of Sec. 100 of Cos. Act, 1956 vis-à-vis Sec. 66 of Cos. Act, 2013.

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[2024] 168 taxmann.com 141 (NCLT - Kolkata)
Philip India Ltd., In re

- Unlisted public company (now delisted) proposed a scheme for capital reduction.
- Objective was to pay public shareholders based on 'fair value' of the shares as consideration and provide exit.
- Comparison of provisions of capital reduction – Cos. Act, 1956 vis-à-vis Cos. Act, 2013.

Reasons for capital reduction by Petitioner Co.

Petitioner Company has claimed only two grounds:

- (a) Wanted to provide liquidity/exit for the minority shareholders
- (b) Company wanted to save on administrative cost of servicing large public shareholders with negligible percentage of shareholding

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Whether the purpose of Capital Reduction was 'buy back' of shares?

- *We don't find anything in the pleadings, not even in the written note, involving circumstances mentioned in Sec. 66(a) or 66(b) of the Companies Act, for the purpose of invoking Section 66 of the Companies Act, for capital reduction, in the case in hand.*
- *In the erstwhile Section 100 of the Companies Act, 1956, which was dealing with capital reduction, provisions were wide enough and there was no specific bar for* "buy back of shares" *from minority shareholders for the purpose of Capital Reduction.*

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NCLT: Capital Reduction provision provides a specific bar on application to buy back of shares

- *NCLT – In fact, Section 100 of the Companies Act was often used for the said purpose and consequently for capital reduction by Companies. However, Section 66(6) of the Companies Act, 2013, in our view provides specific bar and states that nothing in this Section shall apply to buy-back of its own securities by a Company under Section 68 of the Companies Act, 2013.*

NCLT : Share capital reduction is only incidental to main objective of buy back of shares

- *NCLT – In our view under the current facts and circumstances the Petitioner Company is resorting to buy-back of its own equity shares from the minority shareholders/public shareholders and incidentally reducing the share capital. In other words, share capital reduction is only incidental to the main objective of buy back of shares, even as per their own pleadings.*

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POWERS OF THE REGIONAL DIRECTOR – WHERE THE PRE-CONDITIONS OF SECTION 233(1) OF THE COS. ACT, 2013 ARE NOT SATISFIED.

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[2024] 167 TAXMANN.COM 461 (BOMBAY)

ASSET AUTO INDIA (P.) LTD. V. UNION OF INDIA

- Powers of the Regional Director – where the pre-conditions of section 233(1) of the Cos. Act, 2013 are not satisfied.

SEC. 233(5) OF THE COS. ACT, 2013

- *If the Central Government (i.e. RD) after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it **may** file an application before the Tribunal within a period of sixty days of the receipt of the scheme under sub-section (2) stating its objections and requesting that the Tribunal may consider the scheme under section 232.*

Brief facts for reference

- Petitioner Co. filed an application before Central Government (RD) for processing the scheme of amalgamation
- RD vide impugned order rejected the application on the sole ground that Petitioner nos.2 to 5 were not solvent as per the balance sheet as on 31st March 2017
- It was the petitioner's case that RD had illegally rejected the application u/s 233 without any authority of law.

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Interpretation of 'may' in sec. 233(5) of Cos. Act, 2013

- On a conjoint reading of sub-sections (2), (3), (4) and (5), the phrase "may" used in sub-section (5) will have to be construed as mandatory.
- If the Government is of the view that the scheme is not in the public interest or in the interest of the creditors then same is to be decided by the Tribunal.

… Interpretation of 'may' in sec. 233(5) of Cos. Act, 2013

- If the phrase "may" in sub-section (5) is used as optional then company involved in the amalgamation scheme would be at the mercy of the Central Government if the scheme is rejected without any adjudication;
- It is, therefore, mandatory for the Central Government to make an application before the Tribunal and get adjudication on said issue.

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Ratification by shareholders' Special Resolution – where Co. utilised proceeds of preferential issue for a different purpose

Related case: Terrascope Ventures Ltd. v. SEBI [2022] 142 taxmann.com 54/173 SCL 578 (SAT - Mum.)

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[2024] 159 TAXMANN.COM 422 (SC)
SEBI V. ALPS MOTOR FINANCE LTD.

- Appellant Co. made 6 (six) preferential allotments during the period June 2013 to August 2013;
- Necessary disclosure on the stock exchange platform was made by the company;
- Subsequently, an investigation was made and Stock exchange submitted the report indicating possibility of the mis-utilization of the proceeds in 2016.
- Based on this report, SEBI carried further investigation and the show cause notice was issued.

.... BRIEF FACTS CONTINUED

- SEBI after considering the material evidence on record and after giving an opportunity of hearing concluded that the company had deviated from the object of the issue and did not utilize the proceeds from the preferential issue as per the objects;
- SEBI imposed penalties for alleged violation of SEBI (LODR) Regulations and SEBI (PFUTP) Regulations.

SAT'S OBSERVATIONS:

- Preferential allotment was made in **August 2013**. This fact was known to the stock exchange and to SEBI. No action whatsoever was taken;
- BSE Ltd. itself took cognizance of the alleged violation in **2016** in spite of which it took SEBI another 5 years to issue a show cause notice in **2023;**
- Thus, is an inordinate delay in the issuance of the show cause notice and, there is no justification for issuance of show cause notice at this belated stage.

SAT: Even otherwise – Ratification obtained before SEBI show cause – No violation of any provisions

- *Even otherwise admittedly there was a deviation in the object of the issue and the money was utilized for some other purposes by the company;*
- *Matter was placed before the shareholders in the extraordinary general meeting of the company and the* ***object of the issue was ratified by the shareholders on September 29, 2017****.*
- *Thus, prior to the issuance of the show cause notice, the alleged deviation by the company was ratified and, therefore, there was no violation of any provisions of the LODR Regulations or of the listing agreement on the date when the show cause notice was issued.*

SAT ON 'RATIFICATION' BY SHAREHOLDERS

- Ratification made by the shareholders of the company validates an act already done and even though the company initially utilized the proceeds of the preferential issue for a different purpose in variance of the objects specified, nonetheless, the variance in the utilization of the proceeds should ratified and became authorized pursuant to the special resolution passed by the shareholders on 29-9-2017.

OBSERVATIONS OF SUPREME COURT

- *There is no good ground and reason to interfere with the impugned judgment and hence, the instant appeals are dismissed.*
- *The question(s) of law is left open.*

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WHETHER NOTES OF ACCOUNTS FORMS PART OF THE BALANCE SHEET FOR COMPANIES?

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[2024] 161 TAXMANN.COM 723 (SC)

STATE OF BIHAR V. ZIQITZA HEALTH CARE LTD.

- **Brief facts:**
- In a tender floated by State Health Society for selection of agency for operationalization and management of fleet of ambulances and mortuary vans through integrated centralized call center in State of Bihar, technical committee disqualified bids submitted by companies BVG and 'P'.

.... BRIEF FACTS

- Disqualification of BVG was on the premise that it had not complied with the necessary pre-requisite qualification in filing the **explanatory notes of account being an integral part of the Balance Sheet**;
- Other issue – not relevant for company law matter.
- Appeal to SC:

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SC: "…Balance Sheets can only be understood by going into the factual narrations made in Explanatory Notes of accounts"

- *There is no difficulty in holding that in tune with Section 134(7) of the Companies Act, notes of account do form part of the Balance Sheet;*
- *In other words, the Balance Sheets can only be understood by going into the factual narrations made in the explanatory notes of accounts.*
- *When one speaks about Balance Sheet, it takes along with it the explanatory note;*
- *To be noted, all the other bidders have complied with this part, even M/s. BVG India Ltd. v. State of Bihar [2024] 160 taxmann.com 791 (Patna) was quite conscious of the said compliance as could be seen from one of the communication made by it;*

RELATED PARTY TRANSACTIONS – UNDER REG. 23 OF SEBI LODR REGULATIONS

IN THE MATTER OF LINDE INDIA LTD.

- Regulations 23(1) – Related Party Transactions:
- *23. (1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly:*
- *Provided that a transaction with a related party shall be considered material, if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds rupees one thousand crore or ten per cent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower. …"*

Categorisation of RPTs

- *RPTs are categorised into two buckets with each having a different approval requirement – (a) material RPTs that have to be approved by the shareholders and (b) non–material RPTs which only require Audit Committee approval.*

Determination of 'Materiality' threshold

- *The issue at hand in respect of the first issue involves determining how the 'materiality threshold' is to be calculated.*
- *The Interim Order held that RPTs are deemed to be material if their value during a financial year exceeds 10% of the company's turnover during the previous financial year.*
- *The Company, on the other hand, contended that only transactions executed under a common contract should be considered while determining this 10% threshold.*

Application of principles of Interpretation of Statutes

- *It can be noted that a plain reading of the proviso would indicate that no restriction that confines the calculation to transactions under a common contract can be found in the text. It is well established that the primary rule for interpretation of statutes, including regulations framed by statutory bodies, is the literal rule.*

CALCULATION OF 'MATERIALITY'

- *I, therefore, note that a plain literal interpretation of the statutory provision does not support the interpretation advanced by the Company.*
- *The proviso is explicit in its directive: it establishes a clear and unambiguous criterion for materiality based on the 10% threshold relative to the company's annual turnover.*
- *It is, therefore, noted that there is no textual basis, within the proviso, for confining the calculation of the 'materiality threshold' only to transactions under a common contract, as sought to be contended by the Company.*

CALCULATION OF 'MATERIALITY', IN OTHER CASES:

- It can also be noted that if the interpretation adopted by the Company is adopted, then it would be possible for a given company to structure all its transactions as RPTs and such a move would not need to be placed before the shareholders for approval. All that will be required will be for the company to ensure that such transactions are entered pursuant to different contracts.

SECOND ISSUE BEFORE SEBI

- Whether the allocation of business between Linde India Limited and Praxair India Private Limited would amount to RPT?

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Petitioner was made an accused for acting in discharge of duties of Co. and Co. and persons responsible for day-to-day affairs of Co. were not made parties – Whether such prosecution was an abuse of process of law?

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[2024] 167 taxmann.com 361 (Calcutta)

Santosh Kumar Lahoti v. Registrar of Companies, West Bengal

- Scheme of amalgamation of the company with its WOS Co, was presented for approval before the Regional Director u/s 233 of Cos. Act, and the same was confirmed.
- Shareholders and Creditors meeting were convened of both the companies.
- Form CAA-11 along with its attachments were filed before the RoC by **the CS as Authorized Representatives** of which contained a declaration of the petitioner – that the scheme was approved by requisite majority of shareholders in accordance with Sec. 233.

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COMPLAINT WAS FILED INVOKING SEC. 447 OF COS. ACT, 2013

- RoC filed the complaint petition against Petitioner invoking Sec. 447 for alleging violation of section 448 read with section 233(1)(b) on the ground that the declaration given by the petitioner in Form CAA-11 signifying that the said scheme was approved by the requisite majority of the members and creditors under section 233 (1)(b) was false as 90% of the members or class of members of the transferee company did not approve the scheme of amalgamation.
- ROC issued a show cause notice alleging contravention of section 233(1)(b).

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Petitioner preferred instant revision praying for quashing of complaint & proceeding pending before Special Court

- Petitioner preferred the instant revision praying for quashing of complaint and proceeding pending before the Special Court.
- Petitioner submitted that the scheme was approved by 80 shareholders of holding 100% of the total number present and voting at the meeting of the shareholders.

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Prosecution against petitioner was bad in law

- *It is clear from the petition of complaint that neither the company nor the persons, who were in-charge of the day affairs of the company, have been made parties in the case;*
- *Without the company and the persons responsible for the day to day affairs of the Company, the prosecution of the petitioner alone, who acted on behalf of the company is bad in law and thus clearly an abuse of the process of law.*

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Proceedings pending before Special Court u/s 448 for alleged violation of sec. 233 is bad in law

- *In the petition of complaint all the allegations in respect of the offence alleged are in respect of the company, and acts done on behalf of the company.*
- *But the company and the persons responsible for the affairs of the company have not been made parties.*
- *Thus, in view of the findings above, the proceedings pending before the Special Court under section 448 for alleged violation of section 233 is bad in law and thus liable to be set aside.*

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