Landmark Judgments in Corporate Laws

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SCOPE & COVERAGE

DISCLAIMER

Discussion (mostly) from the perspective of Corporate Secretarial compliance & Corporate Law Advisory

SUBSIDIARY CO.
VS
WHOLLY OWNED SUBSIDIARY CO.

(UNDER INCOME TAX ACT, W.R.T. CAPITAL GAINS TAX)

***Then*, reference to relevant provisions of the Companies Act, 2013.**

CIT VS SUNAERO LTD. [2012] 172 COMP CAS 562 (DELHI)

Issue was: Exemption from capital gains tax in respect of transfer of assets by the subsidiary to Holding Co. was denied on the grounds that the subsidiary was not WOS since some of its shares were held by individuals and they were not proved to be nominees of the Holding Co. holding the shares on its behalf.

CIT VS SUNAERO LTD. [2012] 172 COMP CAS 562 (DELHI)

- Court pointed out that for availing of the benefit under section 47(v) of the Income Tax Act, 1961, the subsidiary must be a wholly-owned subsidiary of the holding company;
- Being a subsidiary is not sufficient. Thus, even if one of the shareholders was not a nominee of the holding company, the benefit under section 47(v) has to be denied.
- Court reiterated the principle that the normal presumption in law is that the registered shareholder holds the shares in his own right and in his individual personal capacity. He does not hold shares as a nominee of a third person;
- It is the contrary which has to be proved by the party who claims or asserts that the recorded shareholder is a nominee. The onus is on the party who claims to the contrary.

Appointment of Managerial Personnel u/s 196(3) of Cos. Act.

***Then*, review under SEBI (LODR) Regulations, 2015**

7 Bombay HC (Single Judge): Director turning 70 years not to attract automatic 'mid-stream' disqualification

Sridhar Sundararajan ('SS')

Vs

Ultramarine & Pigments Ltd. &

Rangaswamy Sampath ('RS')

Bombay High Court

Notice of Motion (L) No. 434 of 2015

(Suit (L) No. 146 of 2015, July 16, 2015)

SEC. 196(3)(a) OF COS. ACT, 2013

No co. shall appoint or continue the employment of any person as MD, WTD or Manager who:

(a) Is below the age of 21 years or has attained age of 70 years:

Provided that appointment of a person who has attained the age of 70 years may be made by passing a special resolution in which case the Explanatory Statement annexed to the notice for such motion shall indicate the justification for appointing such person.

BROAD FACTS

- RS was appointed as CMD of listed co. on August 13, 1990. On May 21, 1998, SS was appointed as director.
- On August 1, 2012, RS was re-appointed as CMD for term of 5 years till 2017. On same day, SS was also appointed as Joint-MD.
- Cos. Act, 2013 was enforced w.e.f. April 1, 2014
- RS attained the age of 70 years on November 11, 2014.
- SS contended that "*On the 70th birthday of RS, he earned himself statutory disqualification*"

KEY OBSERVATIONS OF SINGLE JUDGE

- Section 196(3) does not operate to interrupt the appointment of any director made prior to the coming into force of the 2013 Act, even in a case where the Managing Director crosses the age of 70 years during the term of his appointment;
- And it also does not interrupt the appointment of MD appointed after 1st April 2014 where at the date of such appointment or re-appointment the Managing Director was below the age of 70 years but crossed that age during his tenure;
- There is no mid-tenure cessation of Managing Directorship as a result of Section 196(3)(a);
- All that Section 196(3)(a) does is to sound a note of caution in the public interest and to demand from the company a special resolution when a person who has already crossed the age of 70 at the date is proposed to be appointed or re-appointed. The word '*continue*', therefore, must be read contextually.

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Bombay HC (Division Bench): Automatic disqualification trigger for directors turning 70, though appointment made pre-Cos Act, 2013

Sridhar Sundararajan

vs.

Ultramarine & Pigments Limited

NOTICE OF MOTION (L) NOS. 434 & 2250 OF 2015

SUIT (L) NO. 146 OF 2015

APPEAL (2) NO. 632 OF 2015

FEBRUARY 8, 2016

"MD ATTAINING 70 YEARS WOULD IMMEDIATELY BE DISQUALIFIED"

- Division Bench held that disqualification for MD appointment on ground of age limit would act 'automatically'
- Thus, MD attaining 70 years would immediately be disqualified.
- *RS was disqualified from continuing as MD, unless he fulfilled the requirements of the proviso i.e. company has to continue his appointment by a special resolution and, secondly, that resolution must state the reason why the continuation is necessary.*
- *Language of Sec. 196(3)(a) is plain, simple and unambiguous and it applies to all MDs who have attained the age of 70 years and there is no distinction between MD who have been appointed before April 1, 2014 and those after April 1, 2014.*

CONCLUSION OF DIVISION BENCH

- ✓ *If appointment to the post of MD is made after coming into force of the Amendment Act, 2013 on 1-4-2014, a person who is above the age of 70 years cannot be appointed on account of disqualification, subject to fulfillment of the proviso.*

- ✓ *On the other hand, if he was already appointed prior to 1-4-2014 when he was below the age of 70 years, on account of operation of statute, disqualification, whenever incurred after the Amendment Act, would operate automatically, subject to proviso i.e. special resolution being passed by the Company.*

REG. 17(1A) OF SEBI (LODR) REGULATIONS, 2015

No listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of 75 years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

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DUTIES OF DIRECTORS U/S 166 OF THE ACT

Delhi HC: Director carrying competing business breaches fiduciary duty, imposes restriction, interprets Sec. 166 of the Cos. Act.

Rajeev Saumitra

Vs

Neetu Singh

I.A. NO. 17545 OF 2015. CS (OS) NO. 2528 OF 2015

JANUARY 27, 2016

DUTIES OF DIRECTORS U/S 166 OF THE ACT

(1) Subject to the provisions of this Act, a director of a company shall act in accordance with AoA of Co.

(2) A director of Co. shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the Co., its employees, the shareholders, the community and for protection of environment.

(3) A director of Co. shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

(4) A director of Co. shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

(5) A director of Co. shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the Co.

(6) A director of Co. shall not assign his office and any assignment so made shall be void.

HC: DIRECTOR CARRYING COMPETING BUSINESS BREACHES 'FIDUCIARY DUTY'

- HC held that wife has breached fiduciary duty u/s 166 of Cos. Act, 2013 by initiating competing business;
- Restrained her from using TM of 'Paramount'
- *"She has not exercised her duty with due & reasonable care, diligence & she was involved in the situation in which there was a direct interest that conflicted with co.'s interest, in order to gain advantage by herself and her relatives….. Being a Director, wife is guilty of making undue gain and she is also guilty of carrying out competing business of co."*

HC: "Sec. 166 is akin to common law right"

- In case a Director violates the duties prescribed in Sec. 166, the cause of action accrues in favour of Co.;
- Sec. 166 is akin to the common law right. It is merely repository to Director's fiduciary duties, it does not apply to the shareholder;
- Even if his/her co. may or may not be benefitted from the same, the said party is under a duty to pay over to co. which he or she has betrayed by disloyalty.

HC: Wife has failed to cross the hurdle of mandatory provision of Sec. 166 – Husband has filed solid evidence

- Defendant No.1 in the instant case has failed to cross the hurdle of the mandatory provision of Sec. 166 (which is incorporated in April 2014) in Cos. Act, 2013;
- The plaintiff has filed solid evidence which is unimpeachable, thus common remedy is available to the plaintiff against the act of defendant No.1;

Sec. 88 of Indian Trust Act: Advantage gained by fiduciary

- Where a Trustee, Executor, Partner, Agent, Director of a Company, Legal Advisor, or other person bound in a fiduciary character to protect the interests of another person, by availing himself of his character,
- Gains for himself any pecuniary advantage, or where any person so bound enters into any dealings under circumstances in which his own interests are, or may be, adverse to those of such other person and thereby gains for himself a pecuniary advantage,
- he must hold for the benefit of such other person the advantage so gained.

BOARD MEETINGS THROUGH V/C

(UNDER COS. ACT READ WITH RULES)

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NCLT (New Delhi): Directors are entitled to attend board meeting through VC even if intimation is not given at beginning of calendar year

Rupak Gupta

Vs

U.P. Hotels Ltd.

CA NO. 8/C-II/2016, CP NO. 37 (ND) OF 2015

June 22, 2016

Relevant provisions of board meeting through VC

Rule 3 of Cos. (Meetings of Board and its Powers) Rules, 2014 – relating to meetings of board through VC or other audio visual means.

Rule 3(3)(e): Director, who desire, to participate may intimate his intention of participation through the electronic mode at beginning of calendar year and such declaration shall be valid for one calendar year [*prior amendment*].

Clause (e) substituted by the Companies (Meetings of Board and its Powers) Second Amendment Rules, 2017, w.e.f. July 13, 2017:

Any director who intends to participate in the meeting through electronic mode may intimate about such participation at the beginning of the calendar year and such declaration shall be valid for one year.

Provided that such declaration shall not debar him from participation in the meeting in person in which case he shall intimate the company sufficiently in advance of his intention to participate in person.

NCLT: Obligation upon directors convening the meeting to provide every facility to directors asking VC

- NCLT – Rule 3 is meant for providing video-conferencing, indeed it is the duty of directors convening the Board meeting to inform other directors regarding the options available to them to participate in video-conferencing mode or other audio video mode or other options available to them.
- NCLT – It is the obligation upon directors convening the meeting to provide every facility to directors asking video conference and enable them to participate in Board meeting.

NCLT interprets Rule 3(e) of Cos. (Meetings of Board and its Powers) Rules, 2014:

- NCLT – *"Sub-rule 3(e) only says that if intimation is given at beginning of Calendar Year that will remain valid for entire Calendar Year. It is not said anywhere that if it is not given at beginning of year, Video Conference facility is not to be provided in that Calendar Year. It does not mean that directors are not entitled for Video Conferencing if intimation is not given at beginning of Calendar Year. When a provision is read, it has to be read wholly and not in pieces"*

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NCLAT: Participation in board meeting through video conferencing – Whether right of a director or subject to availability of facility by company?

Achintya Kumar Barua alias Manju Baruah

Vs

Ranjit Barthkur

Company Appeal (AT) No. 17 of 2018

February 8, 2018

NCLAT: Sec. 173(2) gives right to a director to participate in the meting through VC or other audio-visual means

- We find that the provision of Section 173(2) of the New Act read with these Rules as a progressive step. We have got so many matters coming up where there are grievances regarding non-participation, wrong recordings etc. **In our view, Section 173(2) gives right to a Director to participate in the meting through video-conferencing or other audio-visual means and the Central Government has notified Rules to enforce this right and it would be in the interest of the companies to comply with the provisions in public interest.**
- Appellants tried to rely on the Secretarial Standard on Meetings of the Board of Directors to submit that the guidelines are that such participation can be done "if the Company provides such facility". NCLT observed that such guidelines cannot override the provisions under the Rules. The mandate of Section 173(2) read with Rules mentioned above cannot be avoided by the companies.
- NCLAT observed that NCLT took note of the fact that Co. had all necessary infrastructure available.
- NCLAT observed that NCLT came to the conclusion that the provisions of section 173(2) of the 2013 Act are mandatory and the companies not be permitted to make any deviations therefrom.

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Bombay HC: Compulsory voting by postal ballot/e-voting not applicable to Court-convened meetings

In the Scheme of Amalgamation of Wadala Commodities Ltd.

with Godrej Industries Ltd.

Co. Summons for Direction No. 256 of 2014

May 8, 2014

Issue before Bombay High Court:

Whether in view of Sec. 110 of Cos. Act, 2013 and SEBI Circular (May 21, 2013), a resolution for approval of Scheme of Amalgamation can be passed by majority of equity shareholders casting their votes by Postal Ballot (which includes e-voting) in complete substitution of an actual meeting?

HC: Shareholder has an inalienable right to ask questions, seek clarifications and receive responses before he decides which way he will vote.

- Heart of Corp. Governance lies transparency & well-established principle of indoor democracy that gives shareholders qualified, yet definite and vital rights in matters relating to company functioning in which they hold equity.
- Principal among these, is not merely right to vote on any particular item of business, so much as the right to use vote as an expression of an informed decision.
- Schemes of Arrangement/Compromise are amended at a meeting itself. These amendments come from the floor or even perhaps from Board itself. Amendment is then put to vote.
- In a postal ballot, no such amendment is possible. **If we were to restrict ourselves to a postal ballot, no shareholder or any director could ever suggest any amendment. Scheme would stand or fall only in its original form. This is contrary to the mandate of Sec. 391-394 of Cos. Act, 1956.**

HC differentiates between – 'Called' Meeting & 'Ordered' Meeting

- HC – Even so Sec. 230 still speaks of 'calling of a meeting' and 'not merely putting the matter to vote'. It has to be remembered that all schemes that are put to meeting of shareholders are proposed schemes. This means that they are subject not only to approval by voting but also, possibly, to an amendment at the meeting itself.
- Meetings for approval of Schemes u/s 391/394 of 1956 Act are not 'called' by Co. Such meetings are 'ordered' by the Court.
- Nothing could be more detrimental to shareholders' rights than stripping them of the right to question, the right to debate, the right to seek clarification; and, above all, the right to choose, and to choose wisely.
- Vote is an expression of Opinion & it must reflect an informed decision. Dialogue & discourse are fundamental to making of every such decision.

HC: Elimination of all shareholder participation at an actual meeting is anathema to some of the most vital of shareholders' rights

- Provisions for compulsory voting by postal ballot & by e-voting to exclusion of actual meeting cannot & do not apply to 'court-convened meetings'
- At Court convened meetings, provision must be made for postal ballots & e-voting, in addition to an actual meeting.

ISSUE OF FULLY CONVERTIBLE DEBENTURES UNDER COS. ACT – SEC. 62 OR 42 OR 71?

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RIGHTS ISSUE OF FCD – APPLICABLE COMPLIANCE?

The Canning Industries Cochin Ltd.

vs.

SEBI.

Appeal No.115 of 2019

January 28, 2020

BROAD FACTS OF THE CASE

- Unlisted Public Co. with 1929 shareholders
- Co. offered 1,92,900 Unsecured Fully Convertible Debentures of Rs.250/- each to its 1929 shareholders at the rate of 100 FCDs.
- No right to renounce the offer to any other person.
- Maturity of the debentures was 5 years from date of allotment.
- Company sought to raise Rs.25,000/- from each shareholder totalling Rs.4,82,25,000.
- However, the subscription raised through these FCDs was only Rs.2,83,50,000/- from 335 members

KEY OBSERVATIONS OF SAT:

- Provision of Sec. 62(1)(c) is not applicable in the instant case as it is not a case of issuance of preferential shares but is a case of increase of the subscribed capital of Co. caused by the exercise of an option as a term attached to debentures issued by Co. to convert such debentures into shares of Co.
- Sec. 62 would not apply in relation to convertible debentures into shares of the Co. if the foll. condition is satisfied, namely, that the terms of issue of debentures has been approved by Co. by Special Resolution. U/s 62 of the Cos. Act, a Co. is under an obligation, when it proposes to issue further capital, to offer such capital to its own shareholders.
- In regard to debenture stocks or loans which are convertible into shares, the restrictions contemplated u/s 62 will not apply. Section 62(3) is an exception to the other provisions of Section 62. However other conditions contemplated under Rule 18 of the Debenture Rules are required to be complied with.

INTERPRETING 'SELECT GROUP OF PERSONS'

- ✓ Term "select group of persons" though not defined under the Act indicates a specified number of persons.
- ✓ In the instant case, the offer of FCDs has been made only to the shareholders of the Company and to none else. The offer of shares to the Company's shareholders cannot be termed as an offer to a 'select group of persons'.
- ✓ Expression "select group of persons" is not a technical expression but has to be understood in its ordinary popular sense, namely, an offer made privately such as to friends and relatives or a selected set of customers distinguished from approaching the general public or to a section of the public by advertisement, circular or prospectus addressed to the public.
- ✓ Thus, the restriction of subscription of shares to 200 persons or more is not applicable in the instant case as it is not a private placement. Thus, section 42 read with Rule 14(2)(b) of the Securities Rules are not applicable in the instant case.

SAT's Conclusion – issue of Shares vs Debentures

SAT – *We further find that the Company had passed a special resolution under Section 62(3) read with Section 71 in respect of issuance of FCDs. The prospectus and the explanatory statement clearly state that the only members holding equity shares were eligible for allotment. It is clear that the offer of FCDs was made to the existing shareholders of the Company. Consequently, the Company was not required to ensure compliance with the limit of allottees as applicable in the case of private placement of securities.*

ADJUDICATION OF PENALTIES

Section 454 of the Companies Act, 2013 read with Companies (Adjudication of Penalties) Rules, 2014

Rule – 3(2), Cos. (Adjudication of Penalties) Rules, 2014

While adjudging quantum of penalty, the adjudicating officer shall have due regard to the following factors, namely: -

a) Size of the company;

b) Nature of business carried on by the company:

c) Injury to public interest;

d) Nature of the default;

e) Repetition of the default;

f) Amount of disproportionate gain/unfair advantage, wherever quantifiable, made as a result of the default; &

g) Amount of loss caused to an investor or group of investors or creditors as a result of the default:

Provided that, in no case, the penalty imposed shall be less than the minimum penalty prescribed, if any, under the relevant section of the Act.

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Factors to be taken into account while adjudging quantum of penalty [Section 15J of the SEBI Act, 1992]

While adjudging quantum of penalty under section 15-I or section 11 or section 11B of SEBI Act, the SEBI or Adjudicating Officer shall have due regard to the following factors, namely:

(a) Amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) Amount of loss caused to an investor or group of investors as a result of the default;

(c) Repetitive nature of the default.

Adjudicating Officer, SEBI vs. Bhavesh Pabari

CIVIL APPEAL NO(S). 11311 of 2013, February 28, 2019

Issues before the Supreme Court:

- Whether conditions stipulated in clauses (a), (b) and (c) of Section 15-J of SEBI Act are exhaustive to govern the discretion in the Adjudicating Officer to decide on the quantum of penalty or the said conditions are merely illustrative?
- Whether the power and discretion vested by Section 15-J of the SEBI Act to decide on the quantum of penalty, regardless of the manner in which the first question is answered, stands eclipsed by the penalty provisions contained in Section 15-A to Section 15-HA of the SEBI Act?

SC held that the 3 conditions are not exhaustive

- To understand the conditions stipulated in clauses (a), (b) and (c) of Section 15-J of the SEBI Act to be exhaustive and admitting of no exception or vesting any discretion in the Adjudicating Officer would be virtually to admit/concede that in adjudications involving penalties under Sections 15-A, 15-B and 15-C, Section 15-J will have no application. Such a result could not have been intended by the legislature.
- *SC held that the conditions stipulated in clauses (a), (b) and (c) of Section 15J of the SEBI Act are not exhaustive and in the given facts of a case, there can be circumstances beyond those enumerated by clauses (a), (b) and (c) of Section 15J which can be taken note of by SEBI, Adjudicating Officer while determining the quantum of penalty.*

What is 'Shell Company'?

Whether govt. authorities are right in branding a co. as 'Shell Company' ?

Assam Company India Ltd. v. Union of India

| WP(C) NO. 2572 OF 2018, March 7, 2019 | Gauhati HC |

HC: 'Shell Company' – no statutory definition

- The expression 'shell company' has not been defined under any law in India. Therefore, there is no statutory definition of shell company, be it in fiscal statutes or in penal statutes. The Cos. Act, 1956/2013 does not define the expression 'shell company'.
- In Concise Oxford English Dictionary, 11th Revised Edition, Shell Company has been defined as *a non-trading company used as a vehicle for various financial manoeuvres.*

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HC: Shell Co. exists only on paper without having any office and employee

- Shell Co. is understood as having only a nominal existence; it exists only on paper without having any office and employee. Just like a shell which has a thick outer covering but is hollow inside, a Shell Co. is a corporate entity without having active business operations or significant assets;
- It may be used as a deliberate financial arrangement providing service as a tool or vehicle of others without itself having any significant assets or operations i.e., acting as a front. **Popularly shell companies are identified as companies which are used for tax evasion or money laundering, i.e., channelizing crime tainted money or proceeds of crime into the formal economy**.
- But, just being a paper company and not having any assets or business operations *per se* is no offence. A corporate entity may be set up in such a fashion with the objective of carrying out corporate activities in future. That would not make it an illegal entity.

HC: Straightaway Branding Company As 'Shell Company' Was Not Justified

- Considering the negative implications of being branded as a shell company, it was not justified either on the part of the SFIO or SEBI to treat petitioner as a Shell Co. straightaway and thereafter to initiate investigation to justify such branding.
- Principles of natural justice would require that before such branding, petitioner should have been put on notice and afforded a reasonable opportunity of hearing as to why and on what grounds it was being suspected to be a Shell Co. and only if the response was found to be not satisfactory, such a finding could have been recorded.
- **A finding of Shell Co. *de hors* any notice or hearing would not be justified having regard to its negative implications and serious consequences. In the case of petitioner, the circumstances and the context in which it has been declared as a shell company is a virtual condemnation but it is a condemnation without a hearing. That apart, there is also the question of the State or its agencies using an expression which is not defined in any law.**

Immediate disclosure of material event under erstwhile Listing Agreement.

Meaning of 'immediate' & 'material'

NDTV Ltd. v. SEBI

Appeal Nos. 358 of 2015 & 150 of 2018

August 7, 2019

Income tax Assessment order – Whether 'material event'

- The assessment order and the demand raised pursuant thereto is a 'material event' and had a 'material impact' on the profitability/financials of the company;
- It has come on record that the net worth of the company was Rs. 365 crores and a demand of Rs. 450 crores was made in the assessment order. Such demand which eats away the net worth of the company is in our opinion a material event and the assessment order had a 'material impact' which the company was required to report to the Exchange 'promptly' and which was required to be made public 'immediately'.

Interpreting Cl. 36 of Listing Agreement

- *Clause 36 of the Listing Agreement read with the Guidance Note make it apparently clear that the company is required to intimate the Stock Exchange with regard to the material events immediately, which information is required to be made to the public immediately.*
- *The word 'immediately' has to be construed accordingly. It was urged that the word 'immediately' should be construed liberally and not literally and, thus, contended that a reasonable time has to be given to make appropriate disclosure under Clause 36 of the Listing Agreement.*

Imposition of penalty on Compliance Officer

- Imposition of Rs. 2 lakh upon the Compliance Officer for violation of Clause 36 of the Listing Agreement was unjustified.
- *The Compliance Officer works under the direction of the Board of Directors of the Company. It was not open to the Compliance Officer to comply with Clause 36 of the Listing Agreement. At the end of the day, the Compliance Officer is only an employee of the Company and works on the dictates and directions of the management of the Company. Thus, when the entire management is being penalized, it was not open to the AO to also book the Compliance Officer for the said fault.*
- Therefore, the imposition of penalty of Rs. 2 lakh on the Compliance Officer cannot be sustained and, to that extent, the order cannot be sustained.
- Compliance Officer was however liable to comply with the disclosure under SEBI (PIT) Regulations and, to that extent, the penalty imposed by the AO is affirmed.

Corresponding provisions under SEBI (LODR) Regulations, 2015

- Every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material.
- Events specified in Para A of Part A of Schedule III are deemed to be material events and listed entity shall make disclosure of such events.
- Listed entity shall consider the prescribed criteria for determination of materiality of events/ information.
- *Reg. 30 (5) of SEBI (LODR) Regulations, 2015: Board of directors of the listed entity shall authorize one or more KMP for the purpose of determining materiality of an event or information and for the purpose of making disclosures to stock exchange(s) under this Regulation and the contact details of such personnel shall be also disclosed to the stock exchange(s) and as well as on the listed entity's website.*

Q & A SESSION

Thank you ICSI WIRC ! ☺

Thank you Members for active participation!☺

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