* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
COMPANY JURISDICTION

Judgment reserved on : 22.01.2008
+ Judgment delivered on: 30.09.2008

% C.P. No.141 of 2007

In the matter of:
The Companies Act, 1956;

In the matter of:
Petition under Sections 391-394 of the Companies Act, 1956;

And
In the matter of:

Scheme of Arrangement between Nestle India Limited and its shareholders and creditors;

And

Nestle India Limited
having its Registered Office at
M-54, Connaught Circus,
New Delhi- 110001. .....Petitioner Company

Through: Mr. Rajiv Nayyar, Senior Advocate with Mr. Anirudh Das and Mr. Sahil Sharma, Advocates for petitioner company

Ms. Manisha Tyagi, Advocate for the O.L.

Mr. R.D.Kashyap, Dy. ROC.

Ms. Manisha Dhir with Ms. Preeti Dalal, Advocates for the Regional Director.

CORAM:
HON'BLE MR. JUSTICE VIPIN SANGHI

1. Whether the Reporters of local papers may be allowed to see the judgment?
2. To be referred to Reporter or not? Yes
3. Whether the judgment should be reported in the Digest? Yes

VIPIN SANGHI, J.

1. This petition under section 391 -394 of the Companies Act, 1956 (hereinafter referred to as Act) has been filed by the petitioner Nestle India Ltd. to obtain the sanction and approval to the Scheme of Arrangement between the petitioner company and its equity shareholder.

2. Nestle India Ltd. the petitioner company is an existing Company within the meaning of the Act having its registered office at M-5A Connaught Circus, New Delhi 110001.

3. The object of the Scheme of Arrangement between the Petitioner Company and its shareholders and creditors is to pay off the balance in the Securities Premium Account of the petitioner company to the shareholders, and to disburse as special dividend to the shareholders, a part of the balance in General Reserve Account. It is submitted that the Scheme of Arrangement will give an opportunity to the shareholders to earn superior returns, as compared to those which the petitioner company can earn by investing in short term liquid instruments. Such reduction will further enhance the return on equity, provide an opportunity to leverage the balance sheet which in turn could further optimize the cost of capital and thus improve the economic value. To achieve the aforesaid objective, the Scheme proposes:

a) An amount of Rs. 43,23,63,000/- as lying in the Share/Securities Premium Account of the petitioner company be reduced, consequent to which the shareholders of the petitioner company shall be paid off the said amount by the petitioner company in accordance with the

provisions of the Act.

b) An amount of Rs.43,08,57,000/- forming part of the amount voluntarily and excessively transferred by the petitioner company to its General Reserve (i.e the amount in excess of the prescribed 10% of the profits of the company) in accordance with the provisions of the Companies (Transfer of Profits to Reserve) Rules, 1975, during the Financial years 1981 to 1996, be credited to the balance in the "Profit and Loss Account" of the petitioner company, and upon the sanction of the Scheme of Arrangement, be distributed as special dividend to the shareholders of the petitioner company in accordance with the provisions of the Act.

4. It is averred that the Board of Directors of the petitioner company has duly approved the Scheme of Arrangement, and a certified extract of the Resolution passed by the Board of Directors of the petitioner company held on 15.01.2007 has been placed on record.

5. This Court vide order dated 23.03.07 in company Application (M) No. 55 of 2007 and CA Nos.314 & 340 of 2007, issued directions dispensing with the convening of meeting of the secured creditors of the petitioner company while directing the convening of the meeting of the equity shareholders of the petitioner company. So far as unsecured creditors of the petitioner company are concerned, the Court concluded that no useful purpose would be served in holding their meeting. The petitioner company, however, undertook that at the time of issuance of notice on the confirmation petition i.e. the present petition, the petitioner company would invite and consider the objections of the unsecured creditors. In view of the aforesaid, the

Court dispensed with the holding of the meeting of the unsecured creditors as well, to consider the proposed scheme.

6. The meeting of the equity shareholder was held under the supervision of the chairperson appointed by this Court wherein the equity shareholders had approved the Scheme of Arrangement in accordance with the provisions of the Act. A copy of the said report has been placed on record. The original report stands filed on the record of CA(M) No.55 of 2007. As per the chairperson's report, the equity shareholders of the petitioner company were individually served with notices through UPC and by advertisement dated 5th April, 2007 in "Statesman" (English edition) and "Jansatta" (Hindi edition). The meeting was held on 03.05.2007 at 11:30 a.m. at the Air Force Auditorium, Subroto Park, New Delhi-110020. The meeting was attended either personally or by proxy by 182 members of the petitioner company. The shareholders who attended the meeting, by overwhelming majority supported the Scheme. While 164 shareholders, representing 60509611 shares voted in favour of the proposed scheme, 3 shareholders representing 3 shares voted against the Scheme. 15 ballot papers were rejected as invalid. Therefore, the resolution in support of the scheme was approved by 98.2% in number and 99.99% in value of the shareholders present and voting, who constituted 62.67% in value of the total paid up capital of the petitioner company.

7. It is further averred that no investigation/proceedings have been instituted and/ or pending in relation to the petitioner company under section 235 to 251 of the Act.

8. Notice was directed to be issued to the Regional Director (NR) and the Official Liquidator attached to this Court. Citation was directed to be published in "The Statesman" (English) and "Jansatta" (Hindi) in accordance with the Companies (Court) Rules, 1959. It appears that the aforesaid requirement to invite objections from the unsecured creditors, and to consider the same, however, went unnoticed. I heard arguments in the matter and reserved orders on 22.01.2008. While preparing the order, I noticed the aforesaid omission and the matter was listed for directions on 04.04.2008. On 04.02.2008, I directed the petitioner company to comply with the aforesaid requirement and to invite objections from the unsecured creditors by publishing advertisements in "The Statesman" (English) and "Jansatta" (Hindi). In compliance with the said direction, the petitioner published the notices/advertisement in the two newspapers as aforesaid in editions published from various cities on 16.02.2008 and 29.02.2008. These publications have been filed on record alongwith an affidavit of Sh. Pramod Kumar Rai, the authorised representative of the petitioner company. I am satisfied that the petitioner company has given sufficient notice to the unsecured creditors of the proposed scheme. No objection or opposition to the proposed scheme has been received by the Court from any of the unsecured creditors of the petitioner company.

9. The Official Liquidator in his report has submitted that disbursement of Share Premium Amount to the shareholders of the petitioner company appears to be covered by Section 78 read with Sections 100-102 of the Act. However, as regards the amount voluntarily transferred by the Company to its General Reserve over

and above the statutorily required rate in accordance with the provisions of the Companies (Transfer of Profits to Reserve) Rules, 1975 during the financial year 1981 to 1996, it is submitted that the proposed credit of the same in the “Profit and Loss Account” of the company, and its proposed declaration as special dividend does not specifically appear to fall under the provisions of the Act.

10. The Regional Director, Northern Region, Ministry of Company Affairs has, however, stoutly resisted the proposed Scheme of Arrangement of the petitioner company. To oppose the utilisation of the Share Premium Account as proposed, the Regional Director places reliance on Section 78 of the Act, which reads as follows:

> “**78. Application of premiums received on issue of shares**
>
> *(1) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called "the [securities] premium account"; and the provisions of this Act relating to the reduction of the [securities] capital of a company shall, except as provided in this section apply as if the [securities] premium account were paid-up [securities] capital of the company.*
> *(2) The [securities] premium account may, notwithstanding anything in sub-section (1), be applied by the company -*
>
> *(a) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;*
>
> *(b) in writing off the preliminary expenses of the company;*
>
> *(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or*
>
> *(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.*

> *(3) Where a company has, before the commencement of this Act, issued any shares at a premium, this section shall apply as if the shares had been issued after the commencement of this Act:*
>
> *Provided that any part of the premiums which has been so applied that it does not at the commencement of this Act form an identifiable part of the company's reserves within the meaning of Schedule VI shall be disregarded in determining the sum to be included in the [securities] premium account."*

11. It is submitted by Ms. Manisha Dhir, learned counsel for the Regional Director (NR) that the purport of Section 78 of the Act is that the amount lying in the Securities Premium Account can be applied by the company, only for the purposes which are specifically provided for in sub-Section (2) of Section 78 of the Act, and for no other purpose. In the present case, under the proposed Scheme, the petitioner company proposes to utilise the amount lying in the Securities Premium Account for a purpose other than the ones specified in sub section (2) of 78 of the Act and, as such, the said Arrangement is not in conformity with the provision of the Act.

12. On the second aspect of the Scheme of Arrangement i.e the proposed payment of special dividend, from the General Reserves Account after transferring the aforesaid amount to the Profit and Loss Account of the petitioner company, it is contended that there is no provision in the Act permitting the transfer of the amount credited to the General Reserve Account to the "Profit and Loss Account" of the Company as proposed by the petitioner company under the Scheme. The utilization of General Reserve for the purposes of declaration of dividends is governed by Section 205-A read with Companies (Declaration of Dividends out of Reserves) Rules, 1975. The said

Section, in so far as it is relevant, reads as under:

> "***S. 205A. Unpaid dividend to the transferred to special dividend account-***
>
> *(1).....*
>
> *(2).....*
>
> *(3) Where, owing to inadequacy or absence of profit in any year, any company proposed to declare dividend out of the accumulated profits earned by the company in previous years and transferred by it to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be made by the Central Government in this behalf, and, where any such declaration is not in accordance with such rules, such declaration shall not be made except with the previous approval of Central Government."*

13. Thus, it is argued by Ms. Manisha Dhir that the dividend can be declared out of the General Reserves either in accordance with Companies (Declaration of Dividend out of Reserves) Rules 1975 and, if the same is not in accordance with the said Rules, with prior approval of Central Government. Rule 2 of Companies (Declaration of Dividends out of Reserves) Rules, 1975 in so far as it is relevant reads as under:

> "*2. Declaration of Dividend out of Reserves.- In the event of inadequacy or absence of profits in any year, dividend may be declared by a company for that year out of the accumulated profits earned by it in previous years and transferred by it to the reserves, subject to the conditions that-*
>
> *(i) The rate of the dividend declared shall not exceed the average of the rates at which dividend was declared by it in the five years immediately preceding that year or ten per cent of its paid up capital, whichever is less....."*

14. It is submitted that in the present case the petitioner has not stated in the resolution the rate at which it is going to declare the dividend. Further, the paid up capital of the company is

Rs.96,41,75,000/- and the petitioner company intends to transfer a sum of Rs. 43,08,57,000/- from the General Reserves Account to the dividend account which is more than 10% of the paid up capital of the company. Thus the second precondition is not satisfied.

15. The respondent has also relied upon the stated object behind the insertion of Section 205-A in the Companies Act by way of Companies(Amendment) Act, 1974, which reads as under:

> *"It has been observed that large established Companies have been in practice of Declaring dividends in a year in which profits are not adequate for payment of large dividends, out of reserves accumulated in previous years. Such accumulated reserves , which should have been normally available as plougbacks for the furtherance of the company's business, are thus used in a manner prejudicial to the public interest. It is ,therefore, proposed to incorporate in the statue provision to the effect that declaration of dividends out of reserve could be made only in accordance with the the rules to be prescribed by the Central Government or in special cases with the previous approval of the government."*
>
> *"The declaration and payment of dividend in any year , out of the reserves of the past years, cannot be made as a matter of course at the discretion of the board of Directors, but can only be made in accordance with the rules made by the Central Government in this behalf, or in exceptional cases with the previous approval of the central Government."*

16. In reply to the first of the above objections raised by the official liquidator and the Regional Director Northern Region, Mr. Rajiv Nayyar, learned Senior Counsel appearing for the petitioner submits that Section 78 (1) of the Act provides that the amounts lying in the Securities Premium Account can be applied for any purpose. However, for its utilization, the provisions of the Act relating to reduction of share

capital of a company shall apply, as if the Securities Premium Account were paid up share capital of the company. But if the amounts lying in the Securities Premium Account is to be utilized for any of the four specific purposes mentioned in Section 78(2), the same could be done without attracting the provisions of the Act relating to reduction of share capital of the company. Section 78(2) of the Act cannot be read to mean that the amount lying in the Securities Premium Account cannot be applied for any other purpose, other than those specified in Section 78(2) of the Act. The petitioner submits that since the utilisation of the Securities Premium Account in the manner proposed under the Scheme is not covered by Section 78(2) of the Act, the company has complied with the requirements of Section 100 of the Act relating to reduction of share capital. It is further submitted that there is no impediment in reduction of the Securities Premium Account, it being a part of a Scheme under Section 391 of the Act, as long as there is substantial compliance of Rule 85 of the Companies (Court) Rules, 1959. Since the shareholders and creditors have approved and not objected to the Scheme, there is adequate compliance of the requirement of Section 102 of the Act.

17. With regard to the objection regarding the disbursement of amounts as special dividend, which were voluntarily transferred by the petitioner company to its General Reserves in excess of the prescribed 10% of the profits of the Company over the years in the past, by first transferring the same to the Profit and Loss Account of the petitioner company, the petitioner submits that there is no prohibition prescribed either in the Act or under The Companies (Transfer of Profits to Reserves) Rules, 1975 for transferring back from the General Reserve

Account to “Profit and Loss Account”, amounts transferred in excess of the prescribed 10% of the profits of the petitioner company. It is submitted that the amounts transferred to the General Reserves Account, in excess of the requirement prescribed under the Act and the Rules are earnings of the petitioner company which the company was capable of distributing to the shareholders in the respective years in which they were earned. It is further submitted that the General Reserves of the company by its very nature are free Reserves which are not specifically earmarked for any purpose, and are available to the company for utilisation for any purpose, including distribution thereof to the shareholders as special dividend. Petitioner submits that as Section 205(3) permits issuance of bonus shares from the reserves, so in the present case, instead of issuing bonus shares the company is proposing a special dividend payout.

18. The petitioner has relied on ***In Re***: ***Parrys Confectionery Ltd.;*** 2004(122) CC 99.; ***In Re: Karam Chand Appliances (P) Ltd.*** CP No.73/2006 decided on 9.10.2006 by this Court**; *In Re: Hyderabad Industries Ltd.*** [2005] 123 Comp. Cases 458 (AP); **In Re: Raasi Cement Ltd.** 2000(1) ALD 65; ***Novapan India Ltd.*** **(**1996) 5 Comp L J 96 (AP) and ***In re: Cargill India Pvt. Ltd.*** in CP No.175 & 233/2004 decided on 15.10.2004 by this Court, in support of his aforesaid submissions on the interpretation of Section 78(2) and Sections 100 & 101 of the Act. On the hand, the Regional Director (NR) has relied on ***M/s Bharat Fire and General Insurance Ltd. v. The Commissioner of Income Tax, New Delhi*** AIR 1964 SC 1800 and ***Commissioner of Income Tax Vs. Allahabad Bank*** 1969 (2) SCC 143 in support of her submission on the interpretation of Section 78(2)

of the Act.

19. I now proceed to consider the two objections raised by the Regional Director (Northern Region). I shall take up the objection to the application of the "Securities Premium Account" first, and thereafter consider the objection to the disbursement of special dividend, by transferring from the General Reserves, the amount in excess of the prescribed 10% of the profits of the company into the "Profit and Loss Account" of the company.

20. At the outset, I consider it appropriate to analyze the relevant provisions of the Act on my own. The aspect of issue of shares at a premium or at a discount is dealt with in the Act in Sections 78, 79 & 79A. I am only concerned with Section 78 for the present. Section 78(1) states that the premium collected by the company while issuing shares shall be transferred to a separate account called the "Securities Premium Account". The manner in which the amount lying in the "Securities Premium Account" can be utilized and the purposes for which it can be utilized is also provided for by Section 78. Section 78(1) states that the "Securities Premium Account" would be regulated by the provisions of the Act, which deal with the aspect of reduction in the securities capital of a company. However, the provisions of the Act relating to reduction of securities capital would not apply to the "Securities Premium Account", when the same is utilized as provided in the Section itself. Section 78(2) enumerates four specific purposes for which the amount lying in the "Securities Premium Account" may be applied "*notwithstanding anything in sub-Section (1)*". This means, that the provisions of the Act relating to the reduction of the securities

capital are not applicable where the application of the "Securities Premium Account" is for one or more of the four specific purposes enumerated in Section 78(2). A co-joint reading of Section 78(1) and 78(2) of the Act, therefore, leads to the inference that the amounts lying in the "Securities Premium Account", for their application, must comply with the provisions in the Act relating to reduction of securities capital of a company, except when the application of the "Securities Premium Account" is for one or more or the four specific instances enumerated in sub-Section (2) of Section 78. When the application of the "Securities Premium Account" is for one or more of the four specific purposes enumerated in Section 78(2), no further compliance with any of the provisions of the Act relating to reduction of securities capital of a company is necessary and the amount lying in the "Securities Premium Account" can be straightaway be applied for all or any of the said four specific purposes.

21. The argument of the Regional Director (NR) is that the "Securities Premium Account" can be applied only for the specific four purposes mentioned in Section 78(2) of the Act and for no other purpose. To support this interpretation, the learned counsel for the Regional Director, Ms. Manisha Dhir, heavily relies on the use of the expression "*notwithstanding anything in sub-Section(1)*" to submit that sub-Section (2) of Section 78 overrides everything stated in sub-section(1), in relation to the application of the "Securities Premium Account".

22. In my view, the interpretation advanced by learned counsel for the Regional Director (NR) is not correct. If the interpretation as

advanced by the Regional Director (NR) is accepted, it would render otiose the provisions contained in sub-Section (1) of Section 78. The entire Section 78 has to be read as a whole and all the sub-Sections of this Section have to be read and interpreted so as to give a meaningful interpretation. Sub-Section (1) & (2) of Section 78 when read together clearly show that they form part of the same scheme. As aforesaid, the scheme is that the amounts collected as premium while issuing shares, which are required to be transferred to a separate account called the "Securities Premium Account" are governed by provisions of the Act relating to reduction of securities capital of a company. That is the general rule. However, an exception is carved out. The exception is that the provisions of the Act relating to reduction in securities capital would not apply "*as provided in this section*". Therefore, in respect of the specific applications of the "Securities Premium Account" provided in sub-section (2) of Section 78, the general procedure prescribed in sub-section(1) of Section 78 would not apply. If the submission of Ms. Manisha Dhir, Advocate, is accepted that the Securities Premium Account can be utilized only for the four specific purposes, which are enumerated in Section 78(2) and for no other purpose, it could lead to absurd situations. Take for instance, the case of a company which has issued shares at a premium and which does not have any unissued shares, which it proposes to issue as bonus share or any outstanding preliminary expenses which could be written off or any expenses towards commission or discount paid or allowed on issue of shares or debentures of the company, which could be written off and any obligation for payment of premium on redemption of any redeemable preference shares or debentures of the company. If

the submission of the learned counsel for the Regional Director (NR) is accepted, it would mean that such a company, which does not have any outstanding obligation or liability of the kind enumerated in clause (a) to (d) of Section 78(2), can never hope to be able to apply the amount lying in the "Securities Premium Account", and that the same should continue to remain locked till a situation arises wherein the company can utilize it in terms of sub-Section (2) of Section 78. Such an interpretation would give rise to absurd and impracticable results. That does not appear to be the purpose of Section 78(2) of the Act. Sub-Section(2) of Section 78 is engrafted so as to provide greater flexibility to a company, and reduce the need to comply with the rigors of procedure provided for in sub-Section (1) of Section 78 in certain specific cases of application of the "Share Premium Account". The object of Section 78 does not appear to be to unnecessarily and unreasonably limit the flexibility that a company enjoys in dealing with the "Securities Premium Account" by limiting its application only to the four specific instances mentioned in sub-Section (2) of Section 78.

23. In ***Re: Parrys Confectionery Limited*** (supra) the petitioner company sought the confirmation by the Court to the reduction of the share premium account under Section 78 read with Section 101(1) of the Act. As on 31.03.2002, the petitioner company had a sum of Rs.3319.52 Lacs standing to the credit of its Securities Premium Account. Consequent to financial restructuring, the petitioner proposed to apply its "Securities Premium Account" to firstly utilize an amount not exceeding Rs.2500 Lacs out of the said account to set of three heads of losses/ expenditure. The losses/expenditure which were sought to be offset by application of "Securities Premium Account"

were: (i) loss not exceeding Rs.700 Lacs upon the sale of assets, (ii) accumulated loss of Rs.1642.20 Lacs incurred towards products withdrawal and the expenditure relating to the business method restructuring costs for the year ended 31.03.2000, (iii) voluntary retirement/separation expenditure to the tune of Rs.73 Lacs as on 31.03.2003. The proposed reduction in Securities Premium Account in that case also was opposed by raising a similar argument, that the Securities Premium Account can be used only for the specific purposes enumerated in Section 78(2) of the Act. On the other hand, the submission of the petitioner was the same as that advanced by the petitioner herein on the interpretation of Section 78 of the Act. The said submission reads as follows: -

> "10. For which, the learned Counsel for Petitioner contends that Section 78(1) of the Act, specifies that the provisions of the Act relating to Reduction of share Capital of the Company shall, except as provided in that Section, apply as if the Securities Premium Account were the paid up share Capital of the Company. Section 78(1), the Securities Premium Account may be applied by the Company for the purposes set out therein, which are the purposes extracted in the affidavit of the Asstt. Registrar of Companies. Therefore, while reading the two Sub-sections together, the conclusion that would follows would be that where a Company proposes to apply its Securities Premium Account in the manner provided for in Sub-section (2), the provisions relating to reduction of Capital would not be attracted and the Company can do so without either being required to pass a special resolution or seek the confirmation of Court. Section 78(2) is however not exhaustive of the methods in which the Securities Premium Account can be applied by the Company and is only exhaustive of the methods in which such application can take place without following the reduction procedure. Where however, a Company proposes to apply its Securities Premium Account in a manner other than that contemplated in Sub-section (2), then the provisions relating to Reduction of Share Capital would have to be followed in respect of such application."

24. Though the Court did not specifically deal with the

aforesaid submission, as a matter of fact the Madras High Court confirmed the reduction in the Securities Premium Account, even though the application of the Securities Premium Account did not strictly fall in either of the clauses (a) to (d) of sub-Section (2) of Section 78. The reasoning given by the Court for confirming the reduction of the Securities Premium Account was that it was a purely business decision arrived at by the shareholders on the basis of commercial principles and as the restructuring did not involve any cash outflow, the same would not effect the normal operations of the company or its ability to honour its commitments and pay off its debts in the ordinary course of business.

25. Learned counsel or the Regional Director (NR) has sought to distinguish this decision on the ground that in ***Re: Parrys Confectionery Limited*** (supra), there was no cash outflow, and all that was being done was a restructuring which could not effect the normal operations of the petitioner company and its ability to honour its commitments and to pay its debits. However, she points out that in the present case, there is a significant cash outflow if the scheme envisaging the reduction of the "Securities Premium Account" were to be confirmed.

26. In my view, the judgment ***In Re: Parrys Confectionery Limited*** (supra) can be used only as an illustration of an instance where the Court confirmed the reduction in the Securities Premium Account, even though the said reduction was not for the purpose of applying the Securities Premium amount for one of the specific purposes enumerated in sub-Section(2) of Section 78. Though the

argument as advanced by the petitioner herein was raised in that case as well, the Court did not give an express finding and it is only by implication, that one can infer that the submission of the petitioner as extracted hereinabove was accepted by the Court. Similarly, the decision in ***In Re: Karamchand Appliances Pvt. Ltd.***(supra) can also be relied upon only as another instance where the Court confirmed the scheme where under the Securities Premium Account was applied towards payment to preferential shareholders. As pointed out by learned counsel for the Regional Director(NR), the Court did not examine and go into the question whether the company is permitted and allowed to repay and repatriate the securiteis premium paid for purchase of preference shares. This issue was left open by the Court. The Court also made the observation that "*In case there is any restriction and/or no such approval is granted or can be granted for repayment and repatriation of the share premium, this portion of the scheme shall stand nullify and cancelled".*

27. ***In Re: Hyderabad Industries Limited*** (supra) was a case where the appellant company sought confirmation of adjustment of share premium against permanent lost in value of investment made by it in another company. In paragraph 12 of the judgment the Division Bench of the Andhra Pradesh High Court interpreted Section 78 in the manner as suggested by petitioner herein. Para 12 of the said judgment reads as under: -

> "12. The learned Company Judge on a true interpretation of Section 78 of the Act read with Sections 100, 101 and 102 correctly came to the conclusion that if the Share Premium Account is to be applied to any of the purposes mentioned in Sub-section (2) of Section 78, the company need not seek

> the approval/confirmation of the Company Court. ***It is only in case the company desires to apply Share Premium Account for any other purpose, it has to approach the Company Court for confirmation.*** The learned Company Judge had also rightly observed that there could be myriad situation where the Company may have to use Share Premium Account or reserve or reserve fund provided such use is authorized by the Articles of Association and must be within the four corners of law." (**emphasis supplied**)

28. The submission of learned counsel for Regional Director(NR) is that in this case as well, as in the case of ***In Re: Karamchand Appliances Pvt. Ltd*** *(supra)* and ***In Re: Parry Confectionery Limited*** (supra) the "Securities Premium Account" was applied to offset losses. However, I am not impressed with this argument of learned counsel for the Regional Director(NR). It does not matter whether the Securities Premium Account has been applied for offsetting accumulated losses or for any other purpose. What is of relevance in the present context is that the share premium account was applied for a purpose other than the four specifically mentioned purposes in Section 78(2) of the Act. Moreover, the principles stated by the Division Bench of the Andhra Pradesh ***In Re: Hyderabad Industries Limited*** (supra) is in general terms, and is not confined to only such cases where the Securities Premium Account has been applied to offset accumulated losses.

29. In ***G.V.K.Hotels/Novopan India Ltd***. **In Re**: [1977] 88 Comp Cas 596, the Andhra Pradesh High Court observed:

> "Para 12: In view of the aforesaid legal position there is no prohibition or legal impediment for reduction of share capital being a part of the scheme of amalgamation. It is permissible as is clear from rule 85 of the Rules. All that is

> required to be done is the procedure prescribed for reduction of share capital is to be complied with. Firstly, it is to be seen whether the articles of association provides for such reduction of share capital. Once it provides for the same, the next thing to be seen is whether such reduction of share capital involves diminution of liability in respect of unpaid share capital or payment to any shareholder or any paid-up share capital. If it involves the same, then the procedure prescribed under sub-section (2) of section 100 has to be followed If not, a date may be fixed for hearing of the petition and advertisement of the petition would satisfy the legal requirements. ***If the said reduction of share capital is of security premium account and the purpose of the said reduction is not what is stipulated under section 78, again law requires the procedure to be followed under section 100 which is provided for insofar as reduction of share capital is concerned.*** It is to be noticed here the two persons whose interest are going to affected, insofar a reduction of share capital is concerned, are shareholders and creditors of the company."(emphasis supplied).

30. The aforesaid decisions are relied upon by this Court in ***In Re: Cargill India P. Ltd.*** (supra). Learned counsel for the petitioner also relies on another decision of the Andhra Pradesh High Court in ***In Re: Hyderabad Industries Ltd***, in C.P.No. 169 of 2003, decided on 27.4.2004, reported as [2005] 123 Comp Cas 446(AP). In this decision the Court held:

> "20. Reverting back to Section 78 again, sub-section (1) thereof is in two parts. First part imposed a legal obligation for transferring the share premium to the account called share premium account. The second part says that except as provided in Section 78, the provisions relating to reduction of share capital would apply. Sub-section(2) of Section 78 contains a non-obstante clause. It lays down that notwithstanding Sub-section(1), share premium account may be applied in paying up unissued shares of the Company to be issued to the members as fully

paid bonus shares: or writing off preliminary expenses of the Company; or writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the Company; or providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the Company. The proviso to Sub-section (3) further clarifies that before commencement of the Act, if any share premium account is used as "identifiable part of the Company's reserves", the same shall be disregarded because as per Sub-section (3), if any Company had issued shares at a premium, that money also must be transferred to share premium account. ***A conspectus of the three subsections of Section 78 would reveal that if the share premium account is to be applied to any of the purposes mentioned in subsection(2), the Company need not seek approval/confirmation of the Company Court. If the Company desires to apply share premium account for any other purposes, it has to approach the Company Court for confirmation.***

21. There could be myriad situation, when Company may have to use share premium account or reserve or reserve fund, Schedule VI of the Act, especially Horizontal Form of Balance Sheet, contains instructions to the effect that the word "Fund" (after Reserve) should be used only when such reserve is specially represented by earmarked investments. But such use must be authorized by Articles of Association and must be within four corners of law. As observed above, unless the reduction of the share capital is specifically authorized by the Articles of Association, a Company cannot do so, nor this Court can approve or sanction such resolution. Likewise, unless the Articles of Association of Company permit utilization of share premium account for purposes other than Section 78(2), the Court cannot approve or sanction such resolution. Indeed, any adjustment out of the share premium account must be authorized by law and subject to law……." (**emphasis supplied**)

31. Reliance placed by Ms. Manisha Dhir on ***M/s Bharat Fire and General Insurance Ltd.*** (supra) appears to be misplaced. That was a case dealing with a situation where the amounts collected towards share premium, after being put in a

"Capital Reserve Account" had been utilized for the purpose of declaration of dividend even prior to coming into force of the Companies Act in 1956. It does not have any relevance to the issue in hand. So far as the decision in ***C.I.T. West Bengal*** (supra) is concerned, learned counsel for the Regional Director (NR) has laid great stress on the following observation of the Court in para 8 of the said judgment. "

> "....Section 78 was apparently borrowed from Section 56 of the English Companies Act, 1948 (11 and 12 Geo 6 Chh.38). Before the Companies Act of 1956 there was o provision in the Indian Companies Act, 1913 which required a Company to maintain a separate share premium account. After the coming into force of the Companies Act 1 of 1956 a share premium account had to be maintained and the share premium could not be used otherwise than for the specific purposes mentioned in Section 78(2)".

32. In my view the said observation does not constitute a binding precedent since that is not the ratio decendie of the said decision. In that decision, the Supreme Court was construing the meaning of the expression "*Standing to the Credit of the Share Premium Account*" used in the Explanation to paragraph D, Part II of the Finance Act 2 of 1957. The issue with regard to the scope of Section 78(1) in the light of Section 78(2) and their interplay was not being considered by the Supreme Court. It is well settled that an authority is a binding precedent for what it actually decided. For the aforesaid reasons this decision is not a binding precedent on the proposition being considered by me presently.

33. The aspect of reduction of share capital of a company is dealt with in Sections 100 to 105 of the Act. Upon confirmation by the

Court, the share capital of a company may be reduced "*in any way*", and in particular by paying off any paid up share capital, which is in excess of the wants of the company by passing a special resolution, if so authorized by its articles. Section 189 of the Act deals with ordinary and special resolutions. Section 189(2) states that a resolution is a special resolution when: *(a) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members of the resolution; (b) the notice required under this Act has been duly given of the general meeting; and (c) the votes cast in favour of the resolution (whether on a show of hands or on a poll, as the case may be,) by members who, being entitled so to do, vote in person, or where the number of the votes, if any, cast against the resolution by members so entitled and voting.*

34. In **Novopan India Ltd (supra)** the Andhra Pradesh High Court was dealing with the scheme of amalgamation where reduction of share capital was also involved. The judgment quotes from ***Manickchowk and Ahmedabad Mfg. Co.Ltd***, (1970) 2 Comp LJ 300(Guj), inter alia, the following principles:

> xvii) There is nothing objectionable in the company proposing a scheme of arrangement and compromise and simultaneously proposing reduction of share capital and both can be considered and approved simultaneously.
>
> xviii) Where the scheme of compromise and arrangement comprises within its ambit reduction of share capital, the procedure for reduction must be gone through but if it is shown that the procedure prescribed under section 100 onwards has been carried out simultaneously while submitting the scheme for approval of the creditors and members, the court can, while sanctioning the scheme,

> sanction the reduction of share capital. The important thing to find out would be whether the procedure for reduction of share capital wherever it is mandatory has been strictly carried out and wherever it is directory has been substantially complied with.

35. In ***G.V.K.Hotels/Novopan India Ltd***. In Re: [1977] 88 Comp Cas 596, the A.P. High Court held as under:

> When once the reduction in share capital does not involve the diminution of liability in respect of unpaid share capital or payment of any shareholder to any paid up share capital, the question of their interest being affected is not here. ***Even otherwise, in a petition under Section 391 a meeting is called for of the shareholders and creditors of the company. Therefore, the scheme of amalgamation along with notice a draft copy of the scheme of amalgamation as mandatory requirement is sent to each shareholder and creditor of the company who on going through the same will have a clear picture of the terms of the scheme of amalgamation. They have a right to participate in the said meeting and vote for or against the resolution. Therefore, transparency is achieved in this process. Therefore, the procedure prescribed under Section 100 of the Act is substantially complied with. That is what rule 85 provides for. This provision is made for very good reasons. Thus, reduction of share capital can be brought about as part of scheme of compromise, arrangement or amalgamation. Once shareholder and creditors of the company by a statutory majority approve the scheme of amalgamation and the said scheme of amalgamation is not opposed to public policy and when the auditor has given a report stating the affairs of th company have not been conducted in a manner prejudicial to the interest of the members or public interest the scheme which includes reduction of shares requires to be approved. However, further procedure prescribed under section 100 insofar as share capital is to be followed in addition to the procedure***

***to be followed after sanctioning of the scheme."*(emphasis supplied).**

36. In the instant case the articles of association of the petitioner company provides for reduction of share capital vide Article 58, which reads:

> "58. The COMPANY may from time to time, by special resolution, reduce its share capital, any capital redemption reserves fund or any share premium account in any manner and with, and subject to any incident authorized, and consent required by law."

37. Requisite special resolution has been passed in accordance with the Article of association and also as per the provisions of the Act by the shareholders in the especially convened meeting to seek the approval of the scheme by overwhelming majority. The requirement of Section 189(2) of the Act stand complied with. Neither the creditors nor the shareholders have objected to the passing of the Resolution. The reduction of the Securities Premium Account does not involve the diminution of any liability in respect of unpaid capital. There is no material available on record to show the Scheme may cause any prejudice to any of the shareholders/or creditors. In fact the purpose of the scheme is to give an opportunity to the shareholders to earn superior returns as compared to those which the petitioner company can earn by investing in short term liquid instruments.

38. The petitioner has placed on record its annual report for the year 2006 which contains the audited balance sheet of the petitioner as on 31st December, 2006. The Profit and Loss Account for the year ended 31st December, 2006 shows the profit after taxation at Rs.3,150,965,000. The amount available for appropriation, after adding

the balance brought forward is Rs.3,223,204,000. The surplus carried to the balance sheet is Rs. 104,689,000/- after taking into account the amounts disbursed towards dividend, corporate dividend tax and general reserve. The amount transferred to the general reserve is Rs.315,096,000. The aforesaid figure compare well with those for the year ended 31st December, 2005. During the course of hearing, the petitioner had also produced a copy of the unaudited financial results for the quarter ended 30th September, 2007. They show even higher net sales compared to the same period in the previous years. Total income as on 30th September, 2007 for the quarter ended 30.09.2007 stood at Rs.9,124 million, whereas the corresponding figure for the quarter ended 30th September 2006 was Rs.7,273.3 million. The net profit for the quarter ended 30th September, 2007 stood at Rs.1160.60 million as against Rs.829.8 million for the quarter ended 30th September, 2006. These results were reviewed by the audit committee of the Board of Directors of the petitioner company and approved at the Board meeting held on 30th October, 2007. The aforesaid financial picture of the petitioner even otherwise shows that there are sufficient assets possessed by the petitioner and it is in a financially sound state to meet its liabilities towards its creditors both secured and unsecured. It is presumably for this reason that the secured creditors have given their consent to the proposed scheme and the unsecured creditors have not objected to the scheme despite notice. The shareholders of the petitioner company have also supported the scheme.

39. Now coming to the second aspect of disbursement proposed under the scheme i.e. payment of dividend to the equity

shareholders from the general reserves of the company, after transferring the amount voluntarily and excessively transferred to the General Reserve Account over and above the prescribed 10% of the profits of the company in the years 1981 to 1996 to the Profit and Loss Account, I see no force in the contention of the Regional Director(NR) that the said arrangement is not in conformity with the provisions of the Act.

40. Reliance placed by the Regional Director (NR) on Section 205A(3) appears to be misplaced. The said provision begins with words "*where owing to inadequacy or absence of profit in any year.....*" Therefore, the precondition for the application of the said provision is that there is an "inadequacy or absence of profit" in the year in which the company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by it to the reserves. The facts of the present case show that it is not a case falling under Section 205A(3). It is not the case of the petitioner company that it is seeking to tap into the general reserves of the company to declare dividend on account of inadequacy or absence of profits in any year. Since the present case is not covered by Section 205A(3) of the Act, reliance placed by the respondent on the Companies (Declaration of Dividend Out of Reserves) Rules, 1975 also appears to be misplaced. These Rules have been framed in exercise of powers conferred by subsection (3) of Section 205A read with Clause (a) of subsection (1) of Section 642 of the Act. Rule 2 of these Rules also begins with the words "*in the event of inadequacy or absence of profits.....* "and the declaration of dividend by the company for the year in which such an inadequacy or absence of profits exists are

essential conditions to be satisfied before the aforesaid Rules can be made applicable in a given case. In the present case, neither of these conditions is satisfied. It is not a case of inadequacy or absence of profits in any year and it is not proposed by the petitioner to declare dividend for any such year from out of the general reserves.

41. Section 205 of the Act in effect states that dividend may be declared or paid by a company for any financial year only from out of the profits of the company for that year, arrived at after providing for depreciation or out of accumulated profits for the previous years, after providing for depreciation in accordance with the said section. Sub-Section (2A) of Section 205, in effect, states that no dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation, except after the transfer to the reserves of the company of such percentage of its profits for that year, not exceeding 10%, as may be prescribed. A company is not prohibited from voluntarily transferring a higher percentage of its profits to the reserves in accordance with such rules as may be made by the Central Government in this behalf. "*The Companies (Transfer of Profits to Reserves) Rules, 1975"* have been framed by the Central Government in exercise of power conferred by inter alia, subsection (2A) of Section 205 of the Act. Rule 2 of these Rules reads as follows:

> "2. Percentage of profits to be transferred to reserves-
>
> No dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2) of section 205 of the Act, except after the transfer to the reserves of the company of a percentage of its profits for that year as specified below:-

(i) Where the dividend proposed exceeds 10 per cent but not 12.5 per cent of the paid-up capital, the amount to be transferred to the reserves shall not be less than 2.5 percent of the current profits;

(ii) Where the dividend proposed exceeds 12.5 per cent but does not exceed 15 per cent of the paid-up capital, the amount to be transferred to the reserves shall not be less than 5 per cent of the current profits;

(iii) Where the dividend proposed exceeds 15 per cent, but does not exceed 20 per cent of the paid-up capital, the amount to be transferred to the reserves shall not be less than 7.5 per cent of the current profits; and

(iv) **Where the dividend proposed exceeds 20 per cent of the paid-up capital, the amount to be transferred to reserves shall not be less than 10 per cent of the current profits**."(emphasis supplied).

42. The petitioner has placed on record a statement dated 12.1.2007 tabulating the amount transferred to General Reserves between the years 1981 to 1996. The said tabulation shows the amount that the petitioner company was obliged to transfer to the General Reserves in accordance with the Companies (Transfer of Profits to Reserves) Rule, 1975 in each of these years, as also the amounts actually transferred in each of these years to the general reserves, which was in excess of the requirement of 10%. The said tabulation reads as follows:-

Accounting Year	Profit after tax	Amount transferred to General Reserves	10% of Profit	Amount transferred in excess of 10%
	Rs.'000	Rs.'000	Rs.'000	Rs.'000
(1)	(2)	(3)	(4)	(5)=(3)-(4)
1981	25,092	9,342	2,510	6,832
1982	30,306	10,056	3,031	7,025
1983	44,816	17,816	4,482	13,334
1984	38,063	9,263	3,807	5,456
1985	56,081	27,281	5,609	21,672

1986	103,015	59,815	10,302	49,513
1987	100,305	52,305	10,031	42,274
1988	112,241	64,241	11,225	53,016
1989	130,487	41,230	13,049	28,181
1990	152,075	17,530	15,208	2,332
1991	182,805	30,105	18,281	11,824
1992	203,568	102,868	20,357	82,511
1993	331,761	130,340	33,177	97,163
1994	381,773	45,377	38,178	7,199
1995	544,057	56,234	54,406	1,828
1996	535,554	54,264	53,556	708
Total	**2,971,999**	**728,067**	**297,209**	**430,858**

43. The petitioner has also placed on record a certificate issued by M/s A.F. Ferguson & Co. Chartered Accountants stating that they have checked the aforesaid statement dated 12.1.2007 made by the Company with the audited accounts of the company for the years ended 31.12.1981 to 31.12.1996 and that during the years from 1981 to 1996 an amount of Rs.430,857,000/- has been transferred to the General Reserve in excess of the prescribed 10% of the profits of the Company in the above said years in accordance with the Companies (Transfer of Profits to Reserves) Rule, 1975.

44. The Department of Companies Affairs has issued certain clarifications on the interpretation of Section 205(2A) which have been extracted as annexure-J to the written submissions filed by the petitioner. One of the queries which has been answered by the said department and the answer in respect thereof read:

> *"Query 10: Whether after transfer of 10 per cent of the current profits to reserve, the remaining undistributed profits could be carried forward in the profit and loss account?*
>
> *Answer: The Rules do not prohibit a company from carrying forwards any balance of current profit and loss account without transferring them to reserves."*

45. The department has further clarified vide circular No.21/76[8/30/(205A)/75-CLB] dated 1976 that the term “reserves” mentioned in the Companies (Transfer of Profits to Reserves) Rules framed in pursuance to Section 205(2A) means only “free reserves”.

46. From the answer to query No.10 as above extracted it is clear that a company has the option to either transfer more than the requisite 10% of its current profits to reserve (where it declares a dividend in excess of 20%) or to carry the same forward in the Profit and Loss Account. It is also clear that the said reserve is a “*free reserve*” which means, that there is no lien marked on, or obligation or limitation attached to such reserves. The company is not prohibited by any provision of the Act or the Rules from dealing with its free reserves in a manner, which is not opposed to any provision of the law. Pertinently, what the petitioner proposes to do is to firstly transfer to the Profit and Loss Account and then to disburse as special dividend, only that part of the General Reserves which are in excess of the statutorily required amount of General Reserve that it is obliged to maintain. The amount of Rs.430,857,000/- that it is proposing to disburse as special dividend from the out of the General Reserve by transferring the same to the Profit and Loss Account does not reduce the statutorily required level of General Reserve that the petitioner company is obliged to maintain. The said amounts, which are now sought to be disbursed as special dividend are assets of the company. A company is entitled to distribute its assets to its shareholders, as permitted by law. There is no prohibition to disbursement of the same and no provision of the Act or Rules made thereunder prohibit the disbursement of the aforesaid amount as special dividend, once the

statutory procedures prescribed therefore have been complied with.

47. As aforesaid, the scheme has been approved by the shareholders by overwhelming majority and the secured creditors have given their consent to the same. No objection has been raised by any unsecured creditor despite notice. I, therefore, see no impediment in the petitioner company transferring the amount of Rs.430,857,000/- from the General Reserves to the Profit and Loss Account of the company for being disbursed as special dividend to the shareholders.

48. I, therefore, sanction the scheme proposed by the petitioner company. However, I make it clear that no liability of the company, statutory as well as non-statutory shall stand compromised on account of the approval of the scheme. The petitioner shall be bound to comply with all the statutory requirements and be also liable to pay such levies and duties as may legally be payable on account of the implementation of the scheme.

(VIPIN SANGHI)
JUDGE

September 30, 2008
as/aj/rsk