

HASMUKHLAL MADHAVLAL PATEL AND ANR.

v.

AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

(Civil Appeal No. 8194 of 2018)

JUNE 15, 2023

[K. M. JOSEPH* AND B. V. NAGARATHNA, JJ.]

Companies Act, 1956 – s. 2(32), 81, 81(1A), 81(3), 397, 398 – Companies Act, 1913 – s. 105-C – First respondent is a private limited company having authorised capital of Rs.1 crore – There are three groups i.e. HMP, S and VPP – Appellant nos. 1 and 2 described as the ‘HMP’ Group had 30.80% of the paid up share capital – ‘S’ Group represented by respondent nos. 4 & 5 had 45 per cent share and ‘VPP’ Group represented by respondent nos. 2 & 3 had 24.20 percentage in the paid-up capital – In response to the proposal for a term-loan made by the appellants, Bank advised them to increase Share Capital for minimum level of Rs. 2 Crore – First respondent company send a Notice to its Directors, four in number, viz., the appellants and Respondents 2 & 3 – Meeting was convened on 18.12.2009 – Directors of ‘S’ group resigned earlier and directors of ‘VPP’ Group were granted leave of absence – In the said meeting, the company proposed to issue further shares to its existing members in the ratio of 1:1 – S and VPP group sought to treat the first respondent company as disputed company – Thereafter, in minutes of Extraordinary General meeting of shareholders (27.01.2010), the authorised share capital of the company was increased to 2 crores – VPP Group and the S Group, purported to project a case of mismanagement and oppression by the appellants in the petitions u/s. 397 and 398 of the Companies Act, 1956 – NCLT found that the increase in the share capital and the allotment of shares itself, was not an act of oppression of the rights – NCLAT found that the allotment in the ratio of 1:1 was not oppressive – However, the manner in which allotment is done, may be illegal and, thus, oppressive – The act of increase in the share capital was upheld – The distribution of shares was ‘defective’ – On appeal, held: The authorised capital of a company, which is also known as nominal capital of the company, represents the maximum number of shares that can be issued – It must be indicated in the Memorandum of Association – It can be increased only by the company by passing a resolution in a General Body Meeting – By the Resolution dated 18.12.2009, the Board of Directors had not actually purported to increase the Authorised Capital – The contents of the last paragraph

* Author

SUPREME COURT REPORT: DIGITAL

of the Resolution, makes it abundantly clear that the Board of Directors was aware that the power lay with the General Body of shareholders to bring about an increase in the authorised capital – It has, no doubt, undertaken to resolve to issue further capital, even though it could be said that as on 18.12.2009, there was ‘no further capital’ subsisting in terms of the limit of Rs. 1 crore, which constituted the Authorised Capital as on 18.12.2009 – What is more shares have been offered on a ratio of 1:1 to the existing shareholders – They were given the choice of refusal or to apply for more or lesser number of shares – This is not a case where the Resolution was to allot the further shares to the Directors or Members of their Group alone – There is a concurrent finding that the decision to go in for increase in capital, viz., Authorised Capital, was not vulnerable to attack – The decision was based on the advice given by the Bank – The purpose of the Board of Directors to increase the capital has been admittedly found to be bona fide – An incidental gain, namely the change in the shareholding pattern is entirely the inevitable result of the refusal of the respondent’s groups to apply – On the whole, in the facts, the appellants cannot be described as having acted in a defective or in an unfair manner, in the matter of allotment of further shares particularly when the contention of the respondents about the bona fides of the decision to increase the authorised capital has been found in favour of the appellants.

Partly allowing the appeals, the Court

HELD:

- 1.1 **The Authorised Capital of a company, which is also known as nominal capital of the company, represents the maximum number of shares that can be issued. It must be indicated in the Memorandum of Association. It can be increased only by the company by passing a resolution in a General Body Meeting. In other words, the Authorised Capital cannot be increased by the Board of Directors. It is out of the Authorised Capital that a company issues shares. It then becomes the Issued Capital. Whatever is issued, need not be subscribed to. Whatever is subscribed to, would become the Subscribed Capital. Paid-up Capital is defined in Section 2(32) of the Companies Act, 1956 as including capital credited as paid-up. The Subscribed Capital may be wholly or partly paid-up. [Paras 67, 68]**
- 1.2 **The position under the Companies Act, 1956, under Section 81, remained the same in that it is only the company, in its General Body Meeting, which could increase the Authorised Capital. The position still continued that call it increase in Subscribed**

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

Capital, it must be within the limits of the Authorised Capital. By the Resolution dated 18.12.2009, the Board of Directors had not actually purported to increase the Authorised Capital. The contents of the last paragraph of the Resolution, makes it abundantly clear that the Board of Directors was aware that the power lay with the General Body of shareholders to bring about an increase in the Authorised Capital. It has, no doubt, undertaken to resolve to issue further capital, even though it could be said that as on 18.12.2009, there was 'no further capital' subsisting in terms of the limit of Rs.1 crore, which constituted the Authorised Capital as on 18.12.2009. The Resolution to allot the shares in 1:1 ratio and the indication that shares, which are not applied for, could be the subject matter of allotment to other shareholders, were all to become operative upon the applications being considered. The Minutes further reveal that the consideration of the application was to await the increase in the Authorised Capital in a duly constituted meeting of the General Body of shareholders. It is, no doubt, true that the proper way of doing it could have been to pass a Resolution after the shareholders resolved to increase the Authorised Capital. It is equally true that such a Resolution was passed on 27.01.2010. The question is, as to whether the act of the Board of Directors attracted the opprobrium of it being an act of oppression. We would think that the decisions of the Board of Directors on 18.12.2009, understood as a whole, only means that the Resolution to issue further capital was to become effective only after the Authorised Capital was duly increased. This is not a case where the Board of Directors had resolved to allot the shares otherwise disregarding the mandate of Section 81 of the Act. What is more shares have been offered on a ratio of 1:1 to the existing shareholders. They were given the choice of refusal or to apply for more or lesser number of shares. This is not a case where the Resolution was to allot the further shares to the Directors or Members of their Group alone. There is a concurrent finding that the decision to go in for increase in capital, viz., Authorised Capital, was not vulnerable to attack. The decision was based on the advice given by the Bank. The purpose of the Board of Directors to increase the capital has been admittedly found to be bona fide. An incidental gain, namely the change in the shareholding pattern is entirely the inevitable result of the refusal of the respondent's groups to apply. This Court cannot proceed on the basis that the appellants foresaw and deliberately planned the whole affair. If only the respondents had applied, the situation would not have happened. [Paras 71, 72]

SUPREME COURT REPORT: DIGITAL

- 1.3 As far as the aspect that, the purported object was shown as generating fresh funds but in place of Rs.90 lakhs only Rs.21 lakhs was brought in goes, the fact that the paid-up capital was apparently shown as credited by cancelling loans due by the company to the appellants group, should not prevent this Court from overlooking the fact that the debt-equity ratio has undoubtedly been improved. It must be borne in mind that the whole idea was to get funds from the Bank for the expansion of the company. The case of the respondents that there were loans due to them also may not advance their case. It would have been different if the respondents had applied and sought adjustment of the consideration by cancelling loans given by them to the company and it was rejected. On the whole, in the facts, the appellants cannot be described as having acted in a defective or in an unfair manner, in the matter of allotment of further shares particularly when the contention of the respondents about the bona fides of the decision to increase the authorised capital has been found in favour of the appellants. The appeals are partly allowed. The direction to allot shares in the impugned order is set aside. The order for conducting audit will remain undisturbed. There will be no order as to costs. [Para 73]**

Nanlal Zaver and another v. Bombay Life Assurance Company Limited and another **AIR 1950 SC 172 : [1950] SCR 391 – followed.**

Dale & Carrington Invt. (P) Ltd. And another v. P.K. Prathapan and others **(2005) 1 SCC 212 : [2004] 4 Suppl. SCR 334 – distinguished.**

Needle Industries (India) Ltd. and others v. Needle Industries Newey (India) Holding Ltd. And others **(1981) 3 SCC 333 : [1981] 3 SCR 698 – referred to**

CIVIL APPELLATE JURISDICTION : Civil Appeal No.8194 of 2018.

From the Judgment and Order dated 02.04.2018 of the National Company Law Appellate Tribunal, New Delhi in Company Appeal (AT) No.273 of 2017.

With

Civil Appeal No.8195 of 2018.

Ms. Meenakshi Arora, Sr. Adv., Mohit D. Ram, Ms. Monisha Handa, Rajul Shrivastav, Anubhav Sharma, Advs. for the Appellants.

Ritin Rai, Sr. Adv., S. S. Shroff, Malak Manish Bhatt, Siddharth, Advs. for the Respondents.

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

The Judgment of the Court was delivered by

K. M. JOSEPH, J.

1. The first respondent is a private limited company. It can also be described as a closely held private limited company. The authorised capital of the first respondent was Rs.1 crore. It consisted of ten lakh equity shares of Rs.10/- each. The paid-up capital was also the same. There are three groups. Appellants 1 and 2, together and relatives can be described as the H.M. Patel Group. They had 30.80 percentage of the paid-up share capital. The next Group to be noticed is the Sheth Group which is represented by Respondents 4 and 5, viz., Kirti Kumar Ochachhavlal Sheth and Ashwinikumar Kirtikumar Ochachhavlal Sheth (hereinafter referred to as, 'the Sheth Group', for short). The Sheth Group had 45 per cent share in the paid-up capital. The third Group is represented by Respondents 2 and 3, viz., Manish Vipinchandra Patel and Krunal Vipinchandra Patel. They had 24.20 percentage of the paid-up share capital. They are referred to hereinafter as the 'V.P. Patel Group'.
2. The V.P. Patel Group filed T.P. 197 of 2016 (C.A. 16 of 2012) whereas the Sheth Group filed T.P. 10 of 2016 (C.P. 86 of 2010). The first respondent is the company. Respondents 2 and 3, in both the petitions, are the appellants before us. The V.P. Patel Group and the Sheth Group, through the aforesaid Petitions, purported to project a case of mismanagement and oppression by the appellants in the Petitions styled under Sections 397 and 398 of the Companies Act, 1956 (hereinafter referred to as 'the Act', for short). By Order dated 17.05.2017, the NCLT, Ahmedabad Bench disposed of the petitions with the following directions:

"92. In this set of facts, it is not just and equitable to order winding up of the company. If the company is to be wound up it is not in the interest of the company or and it is not in the interest of the three groups of shareholders. Therefore, this Tribunal is of the view that it is just and expedient to give following directions/ orders in this matter: -

 - (a) In view of the findings on point No. 3 it is held that increase in the authorised share capital of company from rupees one crore to two crores is valid and binding on all the shareholders. However, the allotment of shares in respect of increased share capital

SUPREME COURT REPORT: DIGITAL

shall be made to all the existing shareholders of the Company as on 18.12.2009 in proportion to their shareholding. In case if any shareholder is not willing to subscribe for additional shares, then those shares shall be allotted to other shareholders taking their options again proportionate to their shareholding.

- (b) In view of findings on point No. 4, the removal of respondents 2 and 3 as directors of the company is not valid.
- (c) In view of finding on point No. S, this Tribunal direct that there shall be audit of accounts of the company from the financial year 2009-2010 and determine what are the amounts siphoned by each petitioners and respondents 2 to 5 and place the report before the General Body of the company duly convening Extra Ordinary General Meeting. The company is directed to take steps for recovery of such amounts from the concerned persons.
- (d) Mis. A.R. Sulakhe & Co., 515, Loha Bhavan, Opp. Old High Court, Near Income Tax Circle, Ashram Road, Ahmedabad 380009 is appointed as auditors for the purpose auditing accounts of the company as directed above. The Auditors shall file report before this Tribunal within two months from the date of this order serving copy to the company and its directors. Fee of the auditors is tentatively fixed at Rs. 50,000/- (Rupees fifty thousand only). The auditors are at liberty to ask for further remuneration depending on work load.
- (e) This Tribunal direct the Independent Valuer to determine the fair value of the shares of the first respondent company as on the date of filing (CP 85/2010) TP 10/2016.
- (f) A.S. Gupta & Co., 203/1 New Cloth Market, 1st Floor, Outside Raiput Gate, Ahmedabad 380 002 is appointed as independent valuer to assess the fair value of the shares of the first respondent company as on the date of filing of this petition taking into consideration report of the auditors also. Independent valuer shall file his report fixing fair market value of the shares of the first respondent company before this Tribunal. Valuer shall take up the work of assessing valuation of the shares of the company after report of the auditor is filed. Independent valuer shall file

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

report before this Tribunal within two months from the date of filing auditor's report. Any one of the shareholders is at liberty to file an application before this Tribunal seeking directions/orders regarding the manner and mode in which the shares of company shall be sold and who has to purchase and at what value the shares are to be sold.

- (g) Fee of the independent valuer is tentatively fixed at Rs.50,000/- (Rupees fifty thousand only). The independent valuer is at liberty to ask for further remuneration depending upon the work load.
 - (h) Pending completion of the entire process as per this order there shall not be any alienation of properties both movable and immovable of the respondent no. 1 company by any of the parties.
 - (i) Pending completion of the entire process as per this order there shall not be any allotment of shares or transfer or sale of shares except as indicated in this order.
 - (j) The company shall bear the fee of independent valuer and auditors.
 - (k) Both Petitions are disposed of accordingly. No order as to costs."
3. The appellants thereupon filed Company Appeals under Section 421 of the Companies Act, 2013, viz., Company Appeals (AT)272 and 273 of 2017 against the Common Order in the aforesaid Petitions. The National Company Law Appellate Tribunal, New Delhi (NCLAT) has affirmed substantially the Order passed by the NCLT. The modification was only in regard to paragraph-92C (supra) of the Order of the NCLT. The NCLAT substituted the words 'financial year 2008-2009' in place of '2009-2010'. Affirming the rest of the directions, the Appeals were disposed of. It is this Order, which is impugned in the Appeals before this Court.
4. We have heard Smt. Meenakshi Arora, learned Senior Counsel on behalf of the appellants. We have heard, on the other hand, Shri Nitin Rai, learned Senior Counsel, on behalf of the V.P. Patel Group and Shri Malak Manish Bhat, learned Counsel on behalf of the Sheth Group.

SUPREME COURT REPORT: DIGITAL

5. The bone of contention between the parties has narrowed down to one issue. The appellants take exception to the Order of the NCLAT, affirming the direction of the NCLT, by which, allotment of shares in respect of the increased share capital, was to be made to all the existing shareholders of the company as on 18.12.2009, in proportion to their shareholding. It was the further direction in paragraph-92A (supra) of the NCLT, that in case, if any of the shareholders is not willing to subscribe for additional shares, then, those shares shall be allotted to other shareholders, taking their options again, proportionate to their shareholdings. Smt. Meenakshi Arora, after taking us through the sequence of facts, would point out that after finding that there was no mismanagement or oppression, as alleged and the NCLT and the NCLAT have clearly erred in regard to the above matter. She would submit that first respondent is a private limited company. Section 81 of the Act did not, as such, apply to the company. Nevertheless, this is a case where the appellants have made an offer to all the existing shareholders and, what is more, in the ratio of 1:1. All that happened was since the company was advised that the authorised capital must be increased so that its capital requirements could be considered, the appellants decided to go in for increase in the authorised capital. The authorised capital was increased from Rs.1 crore to Rs.2 crores. She reminds us that this is a case where the Sheth Group quit in April, 2009 by resigning from the Board of Directors. They took away nearly 90 lakhs. On account of their activities, the company had run into rough weather. It was, in such circumstances, the need for increase in the authorised capital was felt. It is further pointed out that though the Sheth Group and the V.P. Patel Group attempted to impugn the decision to increase the authorised capital as an act of mismanagement and oppression, significantly, the NCLT and NCLAT have found no merit in the same. Therefore, once the increase in the capital was not found illegal or malafide, it is inexplicable, it is submitted, as to how the actual allotment of the shares could be found tainted. The rationale in the reasoning, viz., that the allotment was 'defective', was insupportable, it is contended. All the shareholders were given an equal opportunity to apply for shares in proportion to their existing shareholdings (1:1). They could apply for lesser number of shares. They could also apply for

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

more number of shares. Lastly, they could exercise the choice to not apply for any shares at all. This choice was made available to all the shareholders across the Board falling in the three Groups. The fact of the matter is the Sheth group and the V.P. Patel Group did not apply. Without finding any illegality otherwise, the NCLT and NCLAT, it is contended, clearly erred.

6. *Per contra*, Shri Nitin Rai, learned Senior Counsel, would point out that the Court must bear in mind that the first respondent is a closely held company. It is more or less a quasi-partnership and it ran on trust. The authorised capital of the company was Rs.1 crore. Without the company, in the General Body Meeting, resolving to increase the authorised capital, there were no shares, which could have been allotted by the Board of Directors. In this regard, he sought support from Judgment of this Court reported in *Nanlal Zaver and another v. Bombay Life Assurance Company Limited and another*¹. In other words, the authorised capital was increased by the decision of the General Body, only on 27.01.2010. However, the Board of Directors decided to allot shares, which were non-existent, prior to 27.01.2010. The action of the Board of Directors was unauthorised and impermissible in law. He further pointed out that even the V.P. Patel Group and also the Sheth Group had evinced and manifested their dispute in a formal manner with the Registrar of Companies. On account of the dealings of the appellants, the parties were at loggerheads. Though, the contents of the notice sent, was disputed, however, the matter was not pressed. It is further contended that the NCLT has found the allotment flawed. This is for the reason that under law, when allotment of further shares is made by the Board of Directors, the question of allotment of shares, which are not taken up by the shareholders, must be taken up only after the shareholders, in the first place, decline the allotment. In other words, in this case, the appellants have rolled-up the initial allotment, as also the issue relating to further allotment of shares in a single decision and notice. The NCLT has frowned upon the matter and rightly so. No prejudice will be caused, if impugned direction is upheld. He did take up the contention that the shares of the company were not got valued and

SUPREME COURT REPORT: DIGITAL

it was issued on par, viz., at face value of Rs.10/-. The value did not do justice to the actual valuation of the company, which would have been on the higher side. But fairly, Shri Nitin Rai acknowledged that this aspect was not, as such, canvassed before the Tribunal. There is no offer made after 27.01.2010 he points out. He next complained that even proceeding on the basis that the decision to increase the authorised capital was well advised, it is noteworthy that only Rs.21 lakhs came in by way of the allotment of the additional capital. In other words, though the authorised capital was increased from Rs.1 crore to Rs.2 crores and the whole effort was purportedly to infuse fresh capital, in substance, only Rs.21 lakhs came into the coffers of the first respondent company. The additional capital offered was subscribed only in a sum of Rs.90 lakhs. Besides Rs.21 lakhs, which was brought in, the balance of Rs.69 lakhs was shown accounted by way of cancelling the loan due from the first respondent company to the appellants. This would nail the lie of the appellants that they had acted bonafide and in the best interest of the company. It is contended that the object of the appellants was to wrest control of a closely held company and it is this impermissible object, which alone will be frustrated by this Court upholding the concurrent directions of the NCLT and NCLAT.

7. Shri Malak Manish Bhat would echo the contentions addressed by Shri Nitin Rai. The fact that the company is closely held family and Group Unit, is stressed.

ANALYSIS

8. On 24.11.2009, in response to the proposal for a term-loan made by the appellants, the Bank of Baroda, undoubtedly, communicated the following:
 - “1. We advise you to increase Share Capital for minimum level of Rs.2Cr.
 2. We advise you to expand the board of directors so personal guarantee of additional eligible can be available to the bank for increase of bank’s exposure.
 3. We request you to let us know the full details of Reserve and Surplus mentioned in your Balance Sheet as of 31.03.2009.”

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

9. On 08.12.2009, the first respondent company send a Notice to its Directors, four in number, viz., the appellants and Respondents 2 and 3 (the V.P. Patel Group). It must be remembered that the Directors representing the Sheth Group had resigned earlier in the year. The meeting was convened to take place on 18.12.2009. In the Agenda for the Meeting, we find the following, inter alia:

“2. To take note of letter dated 24th November 2009 received from Bank of Baroda, instructing Company to infuse additional funds by way of equity for proposal submitted for Term Loan.

3. To decide on the methodology to increase the equity.

4. To consider increase in Authorised Share Capital of Company from Rs.1,00,00,000/- to Rs.2,00,00,000/-.”

10. The Meeting did take place on 18.12.2009. The Directors of the V.P. Patel Group, viz., Manish Patel and Krunal Patel were granted leave of absence. The first appellant Chaired the Meeting. The second appellant was the other participant as Director. The following is the Minutes of the Meeting:

“MINUTES OF MEETING OF THE BOARD OF DIRECTORS OF AMBIKA FOOD PRODUCT PRIVATE LIMITED HELD ON 18TH DECEMBER, 2009 AT REGISTERED OFFICE OF THE COMPANY AT RAJODA PO. BAVLA - 382 220 AHMEDABAD AT 11.00 A.M.

The following Directors were present:

1. Mr. Hasmukhbhai Madhavlal Patel.

2. Mr. Dilipkumar M. Patel

1. CHAIRMAN OF THE MEETING

Mr. Hasmukhlal Patel, with the consent of the Directors present, chaired the meeting.

2. LEAVE OF ABSENCE

Leave of absence was granted to Mr. Manish Patel, Director and Mr. Krunal Patel, Director.

3. TAKE NOTE OF THE LETTER RECEIVED FROM BANK OF BARODA:

SUPREME COURT REPORT: DIGITAL

It was informed to the Board that Company is in receipt of letter dated 24th November, 2009, advising Company to bring in additional equity of Rs. 100 Lacs in order meet its requirement for proposed Term Loan application. Copy of the letter received from the Bank duly initiated by the Chairman of the purpose of identification was put before the Board. The Board took note of the same.

4. TO DECIDE MEHODOLOGY TO INCREASE THE EQUITY.

It was informed to the Board that in order to raise the equity it would be appropriate that initially offer is made to the existing shareholders. The Board discussed in detail and was of the opinion that the considering the present equity offer be made to exiting shareholders of Company to apply for one equity shares for every share held. It was then resolved as under:

RESOLVED that pursuant to the requirement of the fresh funds for expanding the business activity of the Company, Company be and is hereby authorized to issue 10,00,000 (Ten Lakh) equity shares of Rs. 10/- each at per to the existing shareholders in the ratio of one share for every share held.

RESOLVED FURTHER that shareholders shall have right to apply for and in case of shares not being subscribed by any other shareholder be allotted to the shareholder who is willing to take additional shares.

RESOLVED FURTHER that a notice inviting the shareholders to subscribe for an get allotted their entitlement be forwarded to the shareholders in this regards and the same shall be considered for allotment upon authorized capital for the Company having been increased.”

11. Following this decision, Notice of Extraordinary General Meeting to be held on 27.01.2010, was given. The shareholders were informed that as decided in the Meeting on 18.12.2009, the company proposed to issue further shares to its existing members in the ratio of 1:1. Interested members were required to exercise their rights on or before the 05.02.2010. Next, it was indicated as follows:

“Please note that this is advance intimation and eligibility to apply for shares would be subject to approval of the increase in authorised capital by the shareholders in the EGM to be held on 27th January, 2010.

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

Application Form for applying shares is attached with this letter.”

12. The Special Business, viz., increasing the authorised capital was specified. The first appellant, as Chairman, was also authorised to give effect to the Resolutions.
13. The Application Form for applying and getting the equity shares in the first respondent company, pursuant to the decision dated 18.12.2009, may be noticed:

“APPLICATION FORM

AMBIKA FOOD PRODUCT PRIVATE LIMITED

NH-8, VILL. RAIODA: TALUKA: BAVLA: DIST: AHMEDABAD

PIN:382220

Application for applying and getting equity shares allotted in Ambika Food product Private Limited pursuant to the decision taken by the Board of Directors in their meeting held on 18th December, 2009.

Name of the Share Holder:

Address:

Folio No.:

Number of Share Held: equity share of Rs.10/- each at Par

Number of Shares eligible for application: ____ equity shares

Note for option to be exercised:

- Please tick on the appropriate option below

- Only one option can be exercised

- In correct and more than one selection shall invalidate the form and it shall be presumed that last option is exercised.

- In case of non-selection of any option, it shall be presumed, that last option is exercised.

1. I/We wish to apply for the full number of shares for which I/We am/are eligible.

SUPREME COURT REPORT: DIGITAL

a. I/We enclose herewith an amount of Rs. _____ /- towards our subscription money by way of DD/PO/Cheque No. ____ dated _____ / / 2010.

b. We hereby authorized the company to convert the amount of unsecured deposit of Rs. _____ /- standing to our credit in the books of the Company.

2. We wish to apply for lesser no. __ Equity Shares from which I/ We am/are eligible.

a. I/We enclose herewith an amount of Rs. — —/- towards our subscription money by way of DD/PO/Cheque No. __ dated / / 2010.

b. We hereby authorize the company to convert the amount of unsecured deposit of Rs. _____ /- sanding to our credit in the books of the Company.

3. We wish to apply for higher no. __ Equity Shares from which I/ We am/are eligible.

a. I/We enclose herewith an amount of Rs. _____/- towards our subscription money by way of DD/PO/Cheque No. ____ dated / / 2010.

b. We hereby authorize the company to convert the amount of unsecured deposit of Rs. _____ /- sanding to our credit in the books of the Company.

4. We do not wish to apply for any shares of the company.

I/We hereby agree to accept the Equity Shares applied for on such smaller number as may be allotted to me/us subject to the terms of Application Form and Articles of Association of the Company.

I/We undertake that I/We will sign all such other documents and do all such other acts. necessary on my/our part to enable me/us to be registered as the holder(s) of the Equity Shares which may be allotted to me/us. I/We authorized you to place my/our name(s) on the Register of Members of the Company as the holder(s) of the equity shares and to register and address(es) as given below.

I/We note. that the Board of Directors are entitled in their absolute discretion to accept or reject this application in whole or in part without assigning any reason whatsoever.

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

I/We agree to the allotment of shares subject to the Rules, Regulations and Conditions laid down by Financial Institutions, Securities Exchange Board of India if any and Board of Directors of the Company.

I am/we are Indian National(s) resident in India and I am/we are not applying for Equity Shares as nominee(s) of any person resident abroad or a foreign national.

(Signature of First Holder)

(Signature of Second Holder)

(Signature of Third Holder)

Date:

Place:

Note:

Above signatures should tally with the signatures on record.”

14. On 18.12.2009, the second respondent, viz., Manish Kumar V. Patel, wrote to the Registrar of Companies, Gujarat, requesting that the first respondent company be marked as a disputed company and not to take any documents, papers, forms, including e-forms, on record, as per decision of majority, are not considered. It is stated in the letter that they would be deprived of their basic rights. It is stated that the appellants may increase the authorised capital and allot shares to them and fraudulently take the control of the company. It is further stated that they were in the process of convening Extraordinary General Meeting, to be held shortly, to inform the shareholders and resolve to remove the appellants from the MCA-21 Portal and Record of ROC. We find along with the same, a communication signed by shareholders, which combined the Sheth Group and the V.P. Patel Group and consisted of 68.98 per cent of the shares, supporting the letter seeking to treat the first respondent company as disputed company.
15. Next, we must notice the Minutes of the Extraordinary General Meeting of shareholders held on 27.01.2010. The appellants were the Members, who were present. There was no one from the Sheth Group or the V.P. Patel Group. The authorised share capital of the company was increased to Rs.2 crores. On the very same day, a Meeting took place of the Board of Directors. The

SUPREME COURT REPORT: DIGITAL

appellants participated in the Meeting. Respondents 2 and 3 were given leave of absence. We find the following from the Minutes of the said Meeting:

“MINUTES OF MEETING OF THE BOARD OF DIRECTORS OF AMBIKA FOOD PRODUCT PRIVATE. LIMITED HELD ON 27, JANUARY, 2010 AT REGISTERED OFFICE OF THE COMPANY AT RA.JODA PO.BA VLA - 382 220 AHMEDABAD AT 03.00 P.M.

The following Directors were present:

1. Mr. Hasmukhbhai Madhavlal Patel.
2. Mr. Dilipkumar M. Patel

1. CHAIRMAN OF THE MEETING

Mr. Hasmukhlal Patel, with the consent of the Directors present, chaired the meeting.

2. LEAVE OF ABSENCE

Leave of absence was granted to Mr. Manish Patel, Director and Mr. Krunal Patel, Director.

3. OUT COME OF EXTRA ORDINARY GENERAL MEETING:

It was informed to the Board that Share Holders of the Company has passed Ordinary Resolution for increase in Authorized Share Capital of the Company from Rs. 1,00,00,000/- to Rs. 2,00,00,000/-. The Board has took note of the same. Any one of the director of the Company was then authorized to file the necessary Form 5 with the office of Registrar of Companies.

4. BOARD MEETING FOR ALLOTMENT OF SHARES: PROP

It was informed to the Board that as mentioned Shares Holders of the Company has passed resolution for increase of Authorised Share Capital and therefore, and as per the application and notice already circulated the last date of receipt of application is 5th February, 2010. It is therefore. proposed to convene meeting of the Board of Directors is proposed. to be held on 9th February, 2010, for considering allotment of further issue of Equity Shares. The Board disallowed the matter and decided to hold Board Meeting on 9th February, 2010. It was also informed to the Board that the Company is taking steps to

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

inform the shareholders about the outcome of the meeting so that they can take immediate steps to subscribe to the equity.

5. VOTE OF THANKS:

There being no other business, the meeting ended with vote of thanks to the chair.

Date: 27.01.2010

DIRECTOR

(HASMUKHBHAI PATEL)

CHAIRMAN”

(Emphasis supplied)

16. Pursuant to the same, it is the specific case of the appellants that the shareholders were sent Notices by Registered Post about the decision of the Extraordinary General Body Meeting so that they could take steps to subscribe to the additional capital sought to be raised. There is, indeed, evidence of the Notices. It is true that the respondents still dispute the receipt of the same.
17. On 09.02.2010, we find the following Minutes of the Meeting of the Board of Directors, of the said date:

“MINUTES OF MEETING OF THE BOARD OF DIRECTORS OF AMBIKA FOOD PRODUCT PRIVATE LIMITED HELD ON 9TH FEBRUARY, 2010 AT REGISTERED OFFICE OF THE COMPANY AT RAJODA PO. BA VLA - 382 220 AHMEDABAD AT 11.00 A.M.

The following Directors were present:

1. Mr. Hasmukii'bhai Madhavlal Patel.

2. Mr. Dilipkumar M. Patel

1 . CHAIRMAN OF THE MEETING

Mr. Hasmukhlal Patel, with the consent of the Directors present, chaired the meeting.

2. LEAVE OF ABSENCE

Leave of absence was granted to Mr. Manish Patel, Director and Mr. Krunal Patel, Director.

SUPREME COURT REPORT: DIGITAL

3. ALLOTMENT OF SAHRES:

It was informed to the Board that Company has received 7 Applications from Share Holders, who have shown their interest in further issue of Company. Some of the Share Holders has made application for higher number of shares then what were offered to.

The Board then considered the all application received and having found the same in order passed the following resolutions:

RESOLVED THAT 9,00,000 Equity shares of Rs. 10/- (Ten Only)@ per be and are hereby allotted to the applicants as under:-

Sr. No.	Name of Allottee	Name of Share Allotted
1.	Himanshu Madhavlal Patel	165000
2.	Varshaben Hasmukhlal Patel	140000
3.	Dilipkumar Madhavlal Patel	149000
4.	Jyotsna Dilipkumar Patel	185000
5.	Nisatgkumar Hasmukhlal Patel	92000
6.	Bankimkumar Dilipkumar Patel	71000
7.	Dishaben Hasmukhlal Patel	98000
Total		900000

RESOLVED FURTHER THAT company do issue necessary share certificates for the above shares within the stipulated period and Mr. Hasmukhlala Patel ad Mr. Dilipkumar Patel be and are authorised to sign the said certificates under the Common Seal of the Company.

RESOLVED FURTHER THAT the necessary Return of Allotment in Form 2 be filed with the Registrar of Companies, Gujarat.

Date: 09.02.2010

DIRECTOR
(HASMUKHBHAI PATEL)
CHAIRMAN"

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.**THE FINDINGS OF THE NCLT**

18. Answering the question, as to whether increase in the paid-up capital from Rs.1 crore to Rs.2 crores in the Extraordinary General Body Meeting dated 27.01.2010 was an act of oppression or not, the NCLT finds that Notices for the Board Meeting on 18.12.2009 were sent to all the Directors by registered post. In the Board Meeting on 18.12.2009, decision was taken to convene the shareholders meeting on 27.01.2010 to increase Authorised Share Capital. On the date of the Board Meeting itself, it was found that the V.P. Patel Group wrote to the Registrar of Companies that the H.M. Patel Group (appellants) is going to increase the Authorised Capital. Thus, V.P. Patel Group was having knowledge, it was found, of the proposal to increase the Authorised Capital. After noting the contention of the Sheth Group and V.P. Patel Group that they were insisting on the appellants sending communication by registered post, acknowledgment due, the Notice dated 08.12.2009 to convene the Board Meeting and Notice of the Extraordinary General Meeting dated 24.12.2009, were sent by registered post. The Tribunal finds that the V.P. Patel Group shareholders were having knowledge of the proposal to increase the share capital. The Sheth Group also, with knowledge, did not chose to participate in the Board Meeting on 18.12.2009 and the Extraordinary General Body Meeting on 27.01.2010. The Tribunal, therefore, rejected the contention of the V.P. Patel Group and the Sheth Group that they had not received Notice or had no knowledge of the Board Meeting on 18.12.2009 or the Extraordinary General Body Meeting on 27.01.2010. Next, the Tribunal finds that the Minutes of the Board Meeting and the Extraordinary General Body Meeting clearly show that after complying with the provisions of the Companies Act and Articles of Association, Resolutions were passed to increase the Authorised Share Capital. Pursuant thereto, Resolutions were passed to invite applications from shareholders. Increase in share capital and the allotments had not been given effect since no returns were recorded with the Registrar of Companies because of the objections of the V.P. Patel Group. Therefore, 'the increase in the share capital and the allotment of shares itself and allotment of shares itself, is not an act of oppression of the rights of

SUPREME COURT REPORT: DIGITAL

the V.P. Patel Group and the Sheth Group', is found by the NCLT. It is further found that the removal of the appellants, as directed, was not valid and could not be upheld. Under the point, 'outcome of financial irregularities alleged by the three Groups', it is found that three Groups were at loggerheads. There appeared to be no possibility of the three Groups coming together and conducting affairs of the first respondent company. It is next pointed that the findings of the Tribunal would show that there are no established acts of oppression and mismanagement except some financial irregularities, which require examination by the Board of Directors. Thereafter, we have noticed the directions in paragraph-92 (supra).

19. Next, is the finding in the impugned Order in regard to allotment. The NCLAT also finds that the contention of the Sheth Group and V.P. Patel Group that they did not get Notice of the Extraordinary General Body Meeting, could not be believed. The need to increase the share capital and the circumstances, which led to it, canvassed by the appellants, including the letter dated 24.11.2009 issued by the Bank of Baroda, was found reliable. Dealing with the point pertinent to the Appeals before us, viz, the actual allotment of shares on increase of share capital, it is, inter alia, found that there did not appear to be any discussion by the NCLT regarding allotment of shares.
20. Next, the NCLAT finds that the allotment in the ratio of 1:1 may not be oppressive, it is found. However, the manner in which allotment is done, may be illegal and, thus, oppressive. The direction of the NCLT was found to be not without basis in the records. Referring to the forms for applying for shares, it is noted that they are dated 04.02.2010 and they show that the applications were not in the ratio of 1:1 but much beyond that. For example, it is stated that the wife of the first appellant was having just 20 equity shares. She applied for 98000 equity shares. The contention of the V.P. Patel Group that the members of the appellant Group calculated in advance and applied so as to consume the whole of the increased share capital, anticipating in advance that they can get it, is noted. A reference was made to the Articles of Association and therein the following Article referring to General Authority is referred to as follows:

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.**“General Authority**

Wherever in the Companies Act, 1956 it has been provided that the Company shall have any right, privilege or authority or that Company can not carry out any transaction unless the Company is so authorised by its Articles then in that case, Articles hereby authorise and empower the Company to have such rights, privilege or authority and to carry out such transaction as have been permitted by the Companies Act, 1956.”

21. The argument that in view of the Article, Section 81 of the Act would apply, is noted. It is further noted that even if the appellants had issued Notice in anticipation of the members to apply on increase of share capital, which was, till that point of time, not decided, the offer could not have been of more than 1:1 and the right procedure would have been that after the share capital was increased, claims of 1:1 should have been considered and only, thereafter, the unsubscribed portion, could be offered. The argument based on *Dale & Carrington Invt. (P) Ltd. and another v. P.K. Prathapan and others*², was noted.
22. It was next found that the act of increase in the share capital could be upheld. The distribution of shares was ‘defective’. Even if in anticipation of increase in share capital, if applications in proportion to share already held could be made, but unsubscribed shares could be disposed only after the shareholder declined to accept the shares offered. For this, it is found that there could not have been applications in anticipation. It is next found that the proper and legal procedure has not been followed. The Board Resolution dated 09.02.2010 could not be upheld.
23. The direction of the NCLT was upheld.
24. We can find that the case of the V.P. Patel Group and the Sheth Group based on there being mismanagement and oppression by the appellants, has otherwise been rejected. The complaint that the appellants acted in an oppressive manner or mismanaged the Company, when it decided to increase the authorised capital, has also been rejected. The NCLT has not given any reasoning, as such,

SUPREME COURT REPORT: DIGITAL

as found by the NCLAT for the direction to allot shares to the V.P. Patel Group and the Sheth Group. The NCLAT appears to, however, support the direction on the basis we have noted above.

25. Shri Nitin Rai emphasised that the Board of Directors could not have allotted the shares, when the existing authorised capital was already subscribed and, what is more, paid-up. Putting the cart before the horse, as it were, applications were invited from shareholders to apply for shares which were not existing. In other words, it was only after the increase in the authorised capital by the decision of the Extraordinary General Body Meeting held of the shareholders of 27.01.2010, from Rs.1 crore to Rs.2 crores, that the Board could have resolved to invite applications. In this regard, he drew support from Judgment of this Court in *NanalaZaver and another v. Bombay Life Assurance Company Limited and others*³.
26. In the decision reported in *Needle Industries (India) Ltd. and others v. Needle Industries Newey (India) Holding Ltd. and others*⁴, we notice the following statements:

“110. Before we leave this topic, we would like to mention that the mere circumstance that the Directors derive benefit as shareholders by reason of the exercise of their fiduciary power to issue shares, will not vitiate the exercise of that power. As observed by Gower in *Principles of Modern Company Law*, 4th Edn., p. 578:

“As it was happily put in an Australian case they are “not required by the law to live in an unreal region of detached altruism and to act in a vague mood of ideal abstraction from obvious facts which must be present to the mind of any honest and intelligent man when he exercises his power as a director.”

The Australian case referred to above by the learned Author is *Mills v. Mills* [60 CLR 150, 160] which was specifically approved by Lord Wilberforce in *Howard Smith* [1974 AC 821, 831] . In *NanalaZaver* [1950 SCC 137 : AIR 1950 SC 172 : 1950 SCR 391, 394] too, Das, J. stated at p. 425 that the true principle

3 AIR 1950 SC 172/1950 SCC 137

4 (1981) 3 SCC 333

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

was laid down by the Judicial Committee of the Privy Council in *Hirsche v. Sims* [1894 AC 654, 660-61 : 64 LJ PC 1 : 71 LT 357 : 10 TLR 616] thus:

“If the true effect of the whole evidence is, that the defendants truly and reasonably believed at the time that what they did was for the interest of the company, they are not chargeable with *dolus malus* or breach of trust merely because in promoting the interest of the company they were also promoting their own, or because they afterwards sold shares at prices which gave them large profits.”

111. Whether one looks at the matter from the point of view expressed by this Court in *NanlalZaver* [1950 SCC 137 : AIR 1950 SC 172 : 1950 SCR 391, 394] or from the point of view expressed by the Privy Council in *Howard Smith* [1974 AC 821, 831] the test is the same, namely, whether the issue of shares is simply or solely for the benefit of the Directors. If the shares are issued in the larger interest of the Company, the decision to issue shares cannot be struck down on the ground that it has incidentally benefited the Directors in their capacity as shareholders. We must, therefore, reject Shri Seervai’s argument that in the instant case, the Board of Directors abused its fiduciary power in deciding upon the issue of rights shares.”

(Emphasis supplied)

27. While on the said decision, we find it apposite that bearing in mind the complaint of Shri Nitin Rai, learned Senior Counsel that the shares were not got valued and they were issued without a premium that we notice the following statement:

“120. Finally, it is also not true to say, as a statement of law, that Directors have no power to issue shares at par, if their market price is above par. These are primarily matters of policy for the Directors to decide in the exercise of their discretion and no hard and fast rule can be laid down to fetter that discretion. As observed by Lord Davey in *Hilder v. Dexter* [(1902) AC 474, 480: 71 LJ Ch 781 : 87 LT 311 : 18 TLR 800] : “I am not aware of any law which obliges a company to issue its shares above par because they are saleable at a premium in the market. It depends on the circumstances of each case whether it will be prudent or even possible to do so, and it is

SUPREME COURT REPORT: DIGITAL

a question for the directors to decide.” What is necessary to bear in mind is that such discretionary powers in company administration are in the nature of fiduciary powers and must, for that reason, be exercised in good faith. Mala fides vitiate the exercise of such discretion. We may mention that in the past, whenever the need for additional capital was felt, or for other reasons, NIIL issued shares to its members at par.”

28. Quite apart from the fact that, as noticed by us earlier that Shri Nitin Rai had stated fairly that this point was not urged as such, the aforesaid statement of the law, assures the Court that there may be no merit in the said contention as well, in the facts.
29. Next, we may notice the Judgment of this Court in *Dale & Carrington Invt. (P) Ltd.* (supra). The said case has been referred to by the NCLAT as also the learned Counsel for the respondents. This Court has proceeded to take the view that Directors of a private limited company are to be tested on a much finer scale in order to rule out misuse of power. The Court held:

“11. ... It follows that in the matter of issue of additional shares, the Directors owe a fiduciary duty to issue shares for a proper purpose. This duty is owed by them to the shareholders of the company. Therefore, even though Section 81 of the Companies Act, 1956 which contains certain requirements in the matter of issue of further share capital by a company does not apply to private limited companies, the Directors in a private limited company are expected to make a disclosure to the shareholders of such a company when further shares are being issued. This requirement flows from their duty to act in good faith and make full disclosure to the shareholders regarding affairs of a company. The acts of Directors in a private limited company are required to be tested on a much finer scale in order to rule out any misuse of power for personal gains or ulterior motives. Non-applicability of Section 81 of the Companies Act in case of private limited companies casts a heavier burden on its Directors. Private limited companies are normally closely held i.e. the share capital is held within members of a family or within a close-knit group of friends. This brings in considerations akin to those applied in cases of partnership where the partners owe a duty to act with utmost good

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

faith towards each other. Non-applicability of Section 81 of the Act to private companies does not mean that the Directors have absolute freedom in the matter of management of affairs of the company. In the present case Article 4(iii) of the Articles of Association prohibits any invitation to the public for subscription of shares or debentures of the company. The intention from this appears to be that the share capital of the company remains within a close-knit group. Therefore, if the Directors fail to act in the manner prescribed above they can in the sense indicated by us earlier be held liable for breach of trust for misapplying funds of the company and for misappropriating its assets.”

(Emphasis supplied)

30. It is true that the appellant had 30.80 per cent of the paid-up share capital. The V.P. Patel Group had 24.20 per cent of the paid-up share capital. The Sheth Group had 45 per cent of the paid-up share capital. This is when the authorised capital of the Company was Rs.1 crore. The position, after the authorised capital was increased to Rs.2 crores, on the other hand, is as follows:

The appellants-Group shareholding has increased to 63.58% of the paid-up share capital. The shareholding of the V.P. Patel Group stands at 12.74% of the paid-up share capital. The shareholding of the Sheth Group is 23.68% percentage of the paid-up share capital.

31. The appellants were at the helm of the affairs, undoubtedly, of the first respondent-Company. The first appellant was the Chairman of the Company. Somewhere in April, 2009, the Sheth Group Directors had resigned. The Board of Directors consisted of the appellants and two Directors belonging to the V.P. Patel Group. There is a concurrent finding that the decision taken by the appellants to increase the authorised share capital cannot be treated as an act of oppression or mismanagement. The only question is whether oppression has been occasioned by the manner in which the allotment of the additional shares was done.
32. The first respondent is a private limited company. Section 81(3) of the Act, expressly exempted from the purview of the provision, a private limited company. The same notwithstanding, as held by this Court *in*

SUPREME COURT REPORT: DIGITAL

Dale & Carrington Invst. (P) Ltd. (supra), the conduct of the Directors is to be judged on a higher yardstick. The question would, in the ultimate analysis, trickle down to, whether the Directors acted in the best interest of the Company or were they motivated to consolidate their power in the Company or maintain the power in the Company. Did the Directors act bonafide in that, when a decision was taken to increase the Authorised Share Capital, they were driven by the intention to side-line the other stakeholders in the Company?

33. The fact that the Directors may also benefit from a decision taken primarily with the intention to promote the interest of the Company, cannot vitiate the decision. In other words, if in the implementation of the decision taken primarily with a view to safeguard the interest of the Company, the appellants have made a gain, it cannot by itself render the decision vulnerable.
34. An observation is found in the impugned Order that wife of the first appellant had 20 shares and she has been allotted 96000 shares. At first blush, this leads to suspicion and even shock. However, let us examine what exactly happened. The Board of Directors took a decision to increase the Authorised Share Capital from Rs.1 crore to Rs.2 crores, following the advice given by the Bank of Baroda. This was a perfectly justified decision, being the need of the hour. Since, the Authorised Share Capital is part of the Memorandum of Association of the Company, an increase in the same would be permissible only after it is endorsed in a meeting of the shareholders. Such a meeting was convened on 27.01.2010. It is true that even prior to such a meeting, the Board of Directors had resolved to invite applications from shareholders. The form of application has been produced before us, which we have extracted. The shareholder could, in terms of the form, do four things:
 - i. Since the Board had resolved to allot shares in a ratio of 1:1, the shareholder could apply for one share for every one share held by him;
 - ii. The application form further contemplated that the shareholder could indicate that he wished to apply for lesser number of shares than he was entitled to;

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

- iii. A shareholder could apply for more number of shares than he was entitled to;
 - iv. Lastly, he could express his disinclination to apply for any shares.
35. It is in the backdrop of this form that we must continue with the narrative. The shareholders from the V.P. Patel Group and the Sheth Group, admittedly, did not apply seizing the opportunity given to them. They did not participate in the Extraordinary General Body Meeting held on 27.01.2010 by which the Authorised Capital was increased. Though there is some controversy sought to be raised that the shareholders were not sent any intimation by way of reminder of their right to apply for the shares, we are inclined to hold that the communication was indeed sent in keeping with the decision taken by the Board of Directors, following the Extraordinary General Body Meeting held on 27.01.2010. The members of the appellants Group, on the other hand, applied for shares. Since, it was contemplated that shareholders could apply not only in the ratio of 1:1 but for larger number of shares, apparently, the members of the appellants Group, applied for more number of shares. Thus, though the wife of the first appellant may have been entitled to only 20 shares, if the rights issue was limited to ratio 1:1, since it was decided to give an opportunity to shareholders to apply for more shares than they held and as, apparently, shares were available to be allotted in numbers far greater than what the shareholders were actually holding, the wife of the first appellant, apparently, came to be allotted the seemingly disproportionate number of shares. If the shareholders belonging to the V.P. Patel Group and the Sheth Group had also applied for a larger number of shares than what they held and there was any discrimination or rejection of their application seeking greater number of shares, then, there would have been, indeed, an occasion to find that an act of oppression had been perpetuated. In the absence of any application by members of the V.P. Patel Group and the Sheth Group for shares in any number, we are unable to perceive or characterise the act as oppressive.
36. The respondents pointed out that from the money available, a sum of nearly 25 lakhs was given to the member of the appellants-Group.

SUPREME COURT REPORT: DIGITAL

37. As regards the last complaint, the appellants would point out that actually all that happened was repayment of money brought in earlier by appellant-Group, which was parked with the Company and in connection with the marriage of a family member, the amount was returned. It must be noticed that the allegations and responses from both sides are the subject matter of the audit. We cannot be deflected by the same in ruling on the 'defect' or alleged illegality in the matter of allotment of the shares.
38. The facts in *Dale & Carrington Invst. (P) Ltd.* (supra) are clearly distinguishable. The case represented on facts a situation, where, the efforts were solely directed at consolidating and cornering of power by the person in question. In this case, from the facts, as recounted, we are inclined to think that the shares were offered to the existing shareholders and, what is more, on a fair and equal footing. This is subject to what we hold further.
39. It is contended by respondents that though the Board decided on 27.01.2001 to remind the shareholders of the right to apply, it was not done. Per contra, the appellants contend that the notices were sent and they were also produced. The respondents would however point out that no finding has been rendered.
40. The Notice dated 27.01.2020 sent, reads as follows:

"27th January, 2010

To,

All the shareholders as per list enclosed

Sub.: Outcome of Extra Ordinary General Meeting.

Dear Sir,

We are pleased to inform you that members of the Company remain present at the Extra Ordinary General Meeting of the Company held today, has passed Ordinary resolution for increase in Authorised Share Capital of the Company from Rs. 1Cr. to Rs. 2 Cr.

Therefore, Board will go ahead with the propose further issue of Equity Shares to existing members of the Company. We are once again remind you that last date for furnishing application for

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

subscribing shares would *be* 5th February, 2010. Therefore, you are requested to exercise your right before 5th February, 2010.

Thanking you,

Yours truly,

For Ambika Food Product Private Limited

Director”

41. Now, a contention is taken by respondents that the NCLAT has not found that it was served as such. We bear in mind the following circumstances, however. In regard to the Notice of Extraordinary General Meeting dated 24.12.2009, a contention was taken by the respondents that the postal cover did not contain the papers of Notice but some other communications. Concurring with the NCLT, in its rejection of the respondents’ case, the NCLAT held as follows:

“28. It appears later the VP Patel Group and HM Patel Group before NCLT took up stand that the postal covers sent did not contain papers of Notice but they contained some other communications relating to the company. Thus in effect they tried to claim before the NCLT that the HM Patel Group was playing fraud. However, as the impugned order shows, the learned NCLT had taken up the contention on these grounds and although it was demonstrated before the NCLT that on opening the envelope cover, it had some papers other than Notice of EOGM, NCLT found that bare perusal of the envelopes which were being shown, it could be seen by naked eye that they were once opened and again sealed. Looking to such approach of these litigants, we will not like to trust their contentions that they did not get notice of the EOGM.”

42. We would hold that in regard to the allotment of shares, the respondents Groups were put on notice and they must be treated as having refused to avail of the offer. There is a concurrent finding by the NCLT and NCLAT that the respondents were aware of the increase in share capital as proposed. That the meetings were held in compliance with the law, is concurrently found.
43. The NCLAT reasons that even if applications in proportion to shares already held could be made, unsubscribed shares could be disposed

SUPREME COURT REPORT: DIGITAL

of only after there is a declining to accept the shares offered. It is further found that there could not have been application in anticipation. This means that it is the understanding of the NCLAT that while shares could be applied for, to the extent of 1:1 as offered, but as regards shares being offered in excess of the said ratio, as permitted under the Board Resolution dated 18.12.2009, it would have been done only after a shareholder refused to take shares offered. A shareholder could not apply for excess shares anticipating that the other shareholders would not take up the shares offered.

44. Now, in law, let us first proceed on the basis that the offer was made with the Authorised Capital being such that the acceptance of the offer would keep the capital within the Authorised Capital.

45. A rolled-up offer would involve the following consequences:

A shareholder was free to not apply at all. A shareholder could apply for less than at the ratio of 1:1. He could apply for shares as per the ratio of 1:1. Now, he could under the application form, apply for shares in excess. There was no limit. The legal limit to be crossed in law, is not in dispute. The law contemplates that shares must be subscribed to the extent of 90 per cent of the issued shares. There is no dispute that it was subscribed to the extent of 90%. By permitting all shareholders 'equally' to apply for shares as indicated hereinbefore, including for shares in excess of the ratio of 1:1, we are not shown any law which stood breached. If all shareholders applied in excess of the entitlement, then, necessarily the Board would have been obliged to distribute the shares on a fair and equal basis, in fact. This contingency did not arise, as the respondents did not apply at all. If some from the respondents Group had applied, then, again the allotment would have been tested with reference to the standard of fairness and equal treatment. This contingency also did not arise. The shareholding became slanted in favour of the appellants Group only because they applied for more shares, while the respondents Group refused to participate. In the facts of the case, the application for more shares by the appellants Group and allotment of the shares to them on the basis of the availability of the shares by reason of the choice exercised by the respondents not to participate in the exercise, cannot be treated as defective, illegal or an act of oppression.

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

46. There is no case, that there was any impediment for the respondents to apply, once it is found that they were informed and aware of their right to apply.

In certain situations, a single act could found a case of oppression. This is not a case where allotment of additional shares was made to anyone other than the existing shareholders. This is a case where the terms were applied equally to all the existing shareholders. The change in shareholding, in that the appellants shareholding grew from 30.80% to 63.58% is the result of the respondents refusal to apply despite being given the opportunity.

TWO QUESTIONS SURVIVE

47. One of the complaints of the respondents is that the purported reason for the increase in the authorized capital and the allotment of the shares also was to infuse fresh funds. However, fresh funds came in only to the tune of Rs.21 lakhs. The balance of the consideration for the shares allotted to the appellants group member is shown as debts due from the first respondent company to the members of the appellants group being written off. Therefore, it is contended that the ostensible reason for increase in authorized capital and for the allotment of the shares are fraught with absence of *bonafides* and the real intention was to capture controlling interest in the company. This is sought to be met by the appellants by pointing out that in view of the loan remaining outstanding, there was a skewed debt-equity ratio which was a clog and the result of the company writing off the loan due from the appellants group was to enable the company to present a better financial condition. The respondents would contend that loans were also owing to the respondent's groups.
48. The second contention which remains is the fact that on 18.12.2009 when the Board of Directors decided to issue 10 lakh shares in the ratio of 1:1, and what is more, giving a right to the shareholders to apply for, and in case of shares not being subscribed by other shareholders, to be allotted those shares to those who were willing to take additional shares, it was all done in anticipation that the shareholders would approve of the increase in the authorized capital from Rs.1 Crore to Rs.2 Crore. In other words, the very authority of the Board of Directors to decide upon to the further issue of shares

SUPREME COURT REPORT: DIGITAL

is questioned as it involved the offer of shares being made when the authorized capital was Rs.1 Crore only. The cart could not be put before the horse. The first step should have been to hold the shareholders meeting and the shareholders should have approved the increase in authorized capital. It was only thereafter that, in other words, the Board of Directors could do what it purported to do on 18.12.2009.

49. Support is drawn in this regard from the judgment of this Court in Nanlal Zaver (supra).
50. The case of the appellants on the other hand is that it was made clear in the decision of the Board of Directors meeting on 18.12.2009 that a notice inviting the shareholders to subscribe in terms of its decision as already noticed was issued and the applications were to be considered for allotment only upon the authorized capital being increased. In other words, though it was resolved to issue 10 lakh shares and to allot them in a ratio 1:1 with the option for the shareholders to apply for even higher number of shares as indicated in the minutes of a meeting on 18.12.2009, the applications to be received from the shareholders were to be considered only after the authorized capital was increased.
51. The decision in Nanlal Zaver (supra) was rendered by a Bench of five learned Judges. Chief Justice Kania, in his opinion proceeded to dismiss the Appeal. Justice M.C. Mahajan and Justice S.R. Das wrote separate concurring opinions. Justice B.K. Mukherjea also agreed that the Appeal must be dismissed and he substantially agreed with the reasoning of Justice S.R. Das. In the Company in question, the authorised Capital was Rs.10 lakhs. The plaintiffs in the Suit, from which the case arose, were aligned with a certain Group, which had proceeded to buy-up the majority shareholding in the Company. It was to, apparently, 'protect the Company' from the Group, which sought to acquire controlling interest in the Company, that the Group in management of the Company decided to issue the balance of the unissued Authorised Capital'. The shares were issued in the ratio of 4:5 to the existing shareholders. It was further decided that any balance shares, which were not applied for, were to be disposed of by the Directors, in the manner they considered

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

best. From the opinion rendered by Justice M.C. Mahajan, we find the following to be one of the two questions, which was articulated:

“11.... (1) whether the issue of further shares by the Directors was in contravention of the provisions of Section 105-C of the Indian Companies Act, ...”

52. Section 105-C of the Companies Act, 1913 read as follows:

“105-C. *Further issue of capital.*—Where the Directors decide to increase the capital of the company by the issue of further shares such shares shall be offered to the members in proportion to the existing shares held by each member (irrespective of class) and such offer shall be made by notice specifying the number of shares to which the member is entitled, and limiting a time within which the offer, if not accepted, will be deemed to be declined; and after the expiration of such time, or on receipt of an intimation from the member to whom such notice is given that he declines to accept the shares offered, the Directors may dispose of the same in such manner as they think most beneficial to the company.”

60. The case of the appellants who were the unsuccessful plaintiffs was based on there being a violation of Section 105-C. In the opinion of Justice M.C. Mahajan, we find the following formulation:

“18. ... The language employed in the section admits of three possible interpretations:

- (1) that its scope is limited to cases where there is an increase in the capital of the company according to the provisions of Section 50;
- (2) that the section covers within its ambit all issue of further capital whether made by increasing the nominal capital or by issuing further shares within the authorised capital;
- (3) that the section has application only to cases where the Directors issue further shares within the authorised limit.”

61. The appellants, in the said case, laid store by the second interpretation whereas the respondents (the company inter alia) took shelter under the third interpretation. Justice M.C. Mahajan held, inter alia, as follows:

SUPREME COURT REPORT: DIGITAL

“23. The third interpretation of the section finds support from the language employed by the legislature in the opening part of the section, wherein it is said:”Where the Directors decide to increase the capital of the company by *the issue of further shares*....” (emphasis supplied) The Directors can only decide to increase the capital at their own initiative when they issue further shares out of the authorised capital. In no other case can the Directors themselves decide as to the increase in the capital of a company. Under Section 50 the capital can only be increased by a resolution of the company. Once the company has increased the nominal capital, then the Directors can issue shares within the new limit. Therefore the authority of the Directors, strictly speaking, in respect to the increase of capital is limited to an increase within the authorised limit. They cannot by their own decision increase the nominal capital of the company. In view of this language the third interpretation of the section seems more plausible.”

62. Justice S.R. Das, in his separate concurring opinion, purported to adopt slightly different reasons while concurring that the Appeal must be dismissed. Justice S.R. Das with whom Justice B.K. Mukherjea also agreed, *inter alia*, held as follows:

“65. ... The first question is whether the section contemplates increase of capital above the authorised limit, or only below the authorised limit. The learned Attorney General appearing for the Company urges that the words “further shares” must be read in conjunction with the words “decide to increase the capital of the company” and, so read, must mean shares which are issued for the purpose of increasing the capital beyond the authorised capital. He contends that Section 105-C has no application to this case.

66. Section 50 deals with, among other things, alteration of the conditions of the memorandum of association of the company by increasing its *share capital* by the issue of *new* shares. The very idea of alteration of the memorandum by the issue of *new* shares clearly indicates that it contemplates an increase of the *share capital* above the authorised capital with which the company got itself registered. This increase can only be done by the company in a general meeting as provided in sub-section (2) of Section 50.

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

This increase above the authorised limit cannot possibly be done by the Directors on their own responsibility. Section 105-C, however, speaks of increase of capital by the issue of further shares. The words used are capital and not share capital and further shares and not new shares. It speaks of increase by the Directors. Therefore, the section only contemplates such increase of capital as is within the competence of the Directors to decide upon. It clearly follows from this that the section is intended to cover a case where the Directors decide to increase the capital by issuing further shares within the authorised limit, for it is only within that limit that the Directors can decide to issue further shares, unless they are precluded from doing even that by the regulations of the company. It is said that Section 105-C becomes applicable after the company in a general meeting has decided upon altering its memorandum by increasing its share capital by issuing new shares. If the company at a general meeting has decided upon the increase of its share capital by the issue of new shares, then it is wholly inappropriate to talk of the Directors deciding to increase capital, because the increase has already been decided upon by the company itself. Further, after the company has at a general meeting decided to increase its share capital by the issue of new shares, the increased capital becomes its authorised capital and then if the Directors under Section 105-C decide to increase the capital by the issue of further shares, then this decision is nothing more than a decision to raise capital within the newly authorised limit. Finally, if Section 105-C were to be held applicable to the case of an increase of capital above the authorised limit then such construction will lead to anomalous results so far as the companies which have adopted Table A, for the section is not consonant with Regulation 42 of Table A which, as will be shown hereafter, applies to increase of capital beyond the authorised limit. If the legislature intended that Section 105-C should apply to all companies in the matter of increase of capital above the authorised limit, then the simplest thing would have been to make Regulation 42 a compulsory Regulation, instead of introducing a section which in its terms differs from Regulation 42 and which therefore makes the position of companies which have adopted

SUPREME COURT REPORT: DIGITAL

Table A anomalous. It appears to me, therefore, for reasons stated above, that Section 105-C becomes applicable only when the Directors decide to increase capital within the authorised limit by the issue of further shares. In this view of the matter that section is clearly applicable to the facts of this case.”

(Emphasis supplied)

63. Section 81 of the Companies Act, 1956 provided for further issue of capital. Section 81(1) read as follows:

“81. Further issue of capital.

(1) Where at any time after the expiry of two years from the formation of a company or at any time after the expiry of one year from the allotment of shares in that company made for the first time after its formation, whichever is earlier, it is proposed to increase the subscribed capital of the company by allotment of further shares, then,

(a) such further] shares shall be offered to the persons who, at the date of the offer, are holders of the equity shares of the company, in proportion, as nearly as circumstances admit, to the capital paid up on those shares at that date;

(b) the offer aforesaid shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days from the date of the offer within which the offer, if not accepted, will be deemed to have been declined; (c) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (b) shall contain a statement of this right;

(d) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of directors may dispose of them in such manner as they think most beneficial to the company.

Explanation.- In this sub- section,” equity share capital” and equity shares” have the same meaning as in section 85.”

(Emphasis Supplied)

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

64. Section 81(1A) permitted offering of shares to any other persons, if certain conditions were met. Section 81(2) read as follows:

“81(2) Nothing in clause (c) of sub- section (1) shall be deemed-

(a) to extend the time within which the offer should be accepted, or

(b) to authorise any person to exercise the right of renunciation for a second time, on the ground that the person in whose favour the renunciation was first made has declined to take the shares comprised in the renunciation.

65. Section 81(3)(a) provided that nothing in Section 81 will apply to a private company. There are other parts of Section 81, which need not detain us. We have already noticed the principles laid down in *Dale & Carrington Invt. (P) Ltd. and another* (supra) as per which though Section 81(3) made the provision inapplicable to private companies, the higher stand applied to private companies.

66. A perusal of Section 81(1) indicates that it dealt with a proposal to increase ‘the subscribed capital’ of the company by allotment of ‘further shares’. Section 105-C of the Companies Act, 1913, which we have noticed, used the words ‘where the Directors decide to increase the ‘capital’ of the company by issue of ‘further shares’. In Section 81 of the Companies Act, 1956, the words used are ‘it is proposed to increase the subscribed capital of the company by allotment of further shares’.

67. The Authorised Capital of a company, which is also known as nominal capital of the company, represents the maximum number of shares that can be issued. It must be indicated in the Memorandum of Association. It can be increased only by the company by passing a resolution in a General Body Meeting. In this regard, we may notice Regulation 44 of Table A of Schedule I of the Companies Act, 1956, which read as follows:

“44. The company may, from time to time, by ordinary resolution, increase the share capital by such sum, to be divided into shares of such amount, as may be specified in the resolution.”

68. In other words, the Authorised Capital cannot be increased by the Board of Directors. It is out of the Authorised Capital that a company

SUPREME COURT REPORT: DIGITAL

issues shares. It then becomes the Issued Capital. Whatever is issued, need not be subscribed to. Whatever is subscribed to, would become the Subscribed Capital. Paid-up Capital is defined in Section 2(32) of the Companies Act, 1956 as including capital credited as paid-up. The Subscribed Capital may be wholly or partly paid-up.

69. We proceed on the basis that an increase in the Authorised Capital does not fall within the powers of the Board, as contemplated in Section 291 of the Act. In Nanlal Zaver (supra), this Court was essentially dealing with the question, as to whether the obligation to offer the shares upon there being a further issue of shares, must be made in conformity with Section 105-C of the earlier Act, which, as we have noticed is essentially the regime continued under Section 81 of the 1956 Act. It is in the said context that the Court held that the Directors could at their own initiative only increase the shares from out of the existing Authorised Capital, but the increase in Authorised Capital could be done only by the company in a meeting of its shareholders. It has been further held that once the Authorised Capital is increased, the Board of Directors would be bound to act under Section 105-C of the Act.
70. In fact, in the said case, the Court found that the expression 'capital of a company' was an ambiguous phrase and may mean either Issued Capital or Authorised Capital, according to the context (See the Judgment of Justice M.C. Mahajan in paragraph-18). In the Judgment of Justice S.R. Das, which we have adverted to, also we find that the view taken is, that the Legislature did not think it safe to leave an uncontrolled discretion to the Directors, when an increase of capital was done by the Directors within the Authorised Capital.
71. The position under the Companies Act, 1956, under Section 81, remained the same in that it is only the company, in its General Body Meeting, which could increase the Authorised Capital. The position still continued that call it increase in Subscribed Capital, it must be within the limits of the Authorised Capital.
72. By the Resolution dated 18.12.2009, the Board of Directors had not actually purported to increase the Authorised Capital. The contents of the last paragraph of the Resolution, makes it abundantly clear that the Board of Directors was aware that the power lay with the

HASMUKHLAL MADHAVLAL PATEL AND ANR. v. AMBIKA FOOD PRODUCTS PVT. LTD. AND ORS.

General Body of shareholders to bring about an increase in the Authorised Capital. It has, no doubt, undertaken to resolve to issue further capital, even though it could be said that as on 18.12.2009, there was 'no further capital' subsisting in terms of the limit of Rs.1 crore, which constituted the Authorised Capital as on 18.12.2009. The Resolution to allot the shares in 1:1 ratio and the indication that shares, which are not applied for, could be the subject matter of allotment to other shareholders, were all to become operative upon the applications being considered. The Minutes further reveal that the consideration of the application was to await the increase in the Authorised Capital in a duly constituted meeting of the General Body of shareholders. It is, no doubt, true that the proper way of doing it could have been to pass a Resolution after the shareholders resolved to increase the Authorised Capital. It is equally true that such a Resolution was passed on 27.01.2010. The question is, as to whether the act of the Board of Directors attracted the opprobrium of it being an act of oppression. We would think that the decisions of the Board of Directors on 18.12.2009, understood as a whole, only means that the Resolution to issue further capital was to become effective only after the Authorised Capital was duly increased. This is not a case where the Board of Directors had resolved to allot the shares otherwise disregarding the mandate of Section 81 of the Act. What is more shares have been offered on a ratio of 1:1 to the existing shareholders. They were given the choice of refusal or to apply for more or lesser number of shares. This is not a case where the Resolution was to allot the further shares to the Directors or Members of their Group alone. There is a concurrent finding that the decision to go in for increase in capital, viz., Authorised Capital, was not vulnerable to attack. The decision was based on the advice given by the Bank. The purpose of the Board of Directors to increase the capital has been admittedly found to be *bonafide*. An incidental gain, namely the change in the shareholding pattern is entirely the inevitable result of the refusal of the respondent's groups to apply. We cannot proceed on the basis that the appellants foresaw and deliberately planned the whole affair. If only the respondents had applied, the situation would not have happened.

SUPREME COURT REPORT: DIGITAL

73. As far as the aspect that, the purported object was shown as generating fresh funds but in place of Rs.90 lakhs only Rs.21 lakhs was brought in goes, the fact that the paid-up capital was apparently shown as credited by cancelling loans due by the company to the appellants group, should not prevent this Court from overlooking the fact that the debt-equity ratio has undoubtedly been improved. It must be borne in mind that the whole idea was to get funds from the Bank for the expansion of the company. The case of the respondents that there were loans due to them also may not advance their case. It would have been different if the respondents had applied and sought adjustment of the consideration by cancelling loans given by them to the company and it was rejected.

On the whole, in the facts, the appellants cannot be described as having acted in a defective or in an unfair manner, in the matter of allotment of further shares particularly when the contention of the respondents about the *bonafides* of the decision to increase the authorised capital has been found in favour of the appellants. The appeals are partly allowed. The direction to allot shares in the impugned order is set aside. The order for conducting audit will remain undisturbed. There will be no order as to costs.

Headnotes prepared by: Ankit Gyan
(Assisted by: Roopanshi Virang, LCRA)

Result of the case: Appeals partly allowed.