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CORPORATE LAWS
Case Law Update

Companies Act

1. In the matter of TEQ GREEN POWER PRIVATE LIMITED (petitioner) versus REMC LIMITED (respondent), Delhi high court order dated 21st March 2023.

Facts of the case

- The Petitioner, TEQ Green Power PVT. Ltd (WOS of O2 Power SG PTE. LTD, Singapore Company) is primarily engaged in generation and supply of power for the purposes of procurement by various nodal agencies and distribution companies.
- The Respondent is the nodal agency of the Indian Railways for implementation of renewable energy projects which is a Joint Venture company between Ministry of Railways and Rites Limited.
- On 14.07.2022, respondent issued a notice inviting tender for selection of project developers for certain power projects. requisite eligibility criteria to be fulfilled by prospective applicants issued along with tender.
- The Petitioner submitted the relevant documents along with the technical bid and financial bid.
- The Respondent opened the technical bids submitted by the applicants. The Petitioner thereafter discovered that other bidders had received advance intimation to participate in the reverse auction and it had not received any intimation regarding the same. Therefore, the Petitioner wrote to the Respondent communicating the same and accordingly requested that the reverse auction be deferred until the said issue resolved.
- The Petitioner, aggrieved of being excluded from the bidding process without being assigned any reasons for such exclusion, proceeded to file a Writ Petition which was disposed of with the following directions to the Respondent:

  "the respondent shall communicate its decision to the petitioner and in the meanwhile, e-reverse auction (e-RA) will remain in abeyance till expiry of one week commencing from the communication of the said decision to the petitioner."
- In furtherance of the directions of the high court, the respondent issued the impugned decision, inter alia

communicating that the Petitioner's bid stood excluded on the grounds that it "...is disqualified at Technical Stage based on the Net Worth of the Parent company is less than the required criteria after exclusion of redeemable preference shares in net worth calculation...".

- Challenging the decision of the Respondent disqualifying the Petitioner from further stage of the tender process, the Petitioner approached this Court by filing the instant petition.

Question of law

Whether the value of preference shares can be included while computing net-worth and accordingly whether the respondent erred in declaring the petitioner ineligible to participate in the tender process in terms of request for selection.

Petitioner's contentions

Learned Senior Advocate for the Petitioner contended that:

- Section 2(57) of the Companies Act the definition of net worth uses the expression "paid-up share capital" which is defined under Section 2(64) of the Companies Act to mean that the paid up share capital is the aggregate amount of money credited as paid up capital and is equivalent to the amount received as paid up capital in respect of shares issued including the amount credited as paid up capital in respect of shares of the company.
- Section 43 of the Companies Act states that the share capital includes equity share capital and preference share capital.
- Second proviso to sub-Section (2) of Section 55 clarifies that the shares cannot be redeemed except out of the profits of the company or out of the proceeds paid from issue of shares made for the purposes of such redemption.
- Preference shares cannot be redeemed from the existing share capital. Therefore, the decision of the Respondents to exclude preference shares from the definition of net worth is contrary to the mandate of law.
- The preference shares issued are redeemable only on the option of the issuer and there is no tenure attached to the shares. Equity share capital of the company is included in the net worth than there is no reason as to why preference shares must be excluded more so if the redemption is only at the instance of the company.
- Further states that here is no correlation between the balance sheet and the net worth. Further contends that for the purpose of balance sheet, both equity share capital and preference share capital are shown as liabilities and, therefore, to arrive at the net worth of the company through accounting classification in a balance sheet only excluding preference capital is illogical.
- The judgment of the Hon'ble Supreme Court in ***JK Industries vs. Union of India, (2007) 13 SCC 673***, states that balance sheet is not an indicator of the net worth of a company.
- Where redeemable preference shares are issued but not honoured when they are ripe for redemption, the holder of those shares does not automatically assume the status of a "creditor". Therefore,

the accounting standards relied upon by the Respondent are inapplicable to the present case since they pertain to preparation of the balance sheet, not computation of net worth.

- In terms of AG 25 of Accounting Standard 32, the test applicable to determine whether preference shares are to be treated as a financial liability or an equity instrument is whether it is redeemable at the option of the holder, as opposed to the issuer and also whether such shares are redeemable at a fixed term or tenure.
- The preference shares in question do not have any term/expiry and are redeemable solely at the option of the issuer as noted in the financial statement submitted as part of the bid. Therefore, even if accounting standards were applicable, the shares in question cannot be treated as a liability.

Respondent's contentions

Learned Senior Advocate for the respondent, submitted that:

- Courts must exercise restraint and caution while dealing with tenders. Further states that the judicial review on administrative action is only intended to prevent arbitrariness, irrationality, unreasonableness, bias and *malafide* and the purpose is only to check whether the decision is made lawfully.
- If the decision taken by the tender issuing authority is made applicable across the board and when there is no evidence of the tenderer adopting the policy of pick and choose, then Writ Courts must not interfere exercising its jurisdiction under Article 226 of the Constitution of India.
- Reliance was placed on Section 129 of the Companies Act read with Schedule III Clause 9 under which a preference share is classified as a liability and redeemable preferences are classified under non-current borrowings or liabilities.
- Further contended that applying the said principles, preference shares are liabilities and, therefore, the decision to exclude preference shares from the definition of the net worth of the company cannot be faulted with
- A balance sheet is required to be prepared in terms of Section 129 of the Companies Act and Accounting Standards notified in terms thereof, and neither Section 129 nor extant accounting standards refer to "net worth" of a company per se.

Held

Court observed the relevant provisions of Companies Act, 2013 as contented by petitioner and observed that:

- Clause 4.3.1 (c) of the tender states that net-worth is to be considered in accordance with the Companies Act, 2013. Further, the tenderer has not specifically excluded preference shares from the definition of net-worth.
- Further court observed that the preference shares in question are preference shares redeemable at the instance of the issuer without any fixed term or tenure attached to these shares.
- Considering the provisions of Companies Act, 2013, it is amply clear that such shares would form part of paid-up share capital which in turn is a component of net-worth

- Therefore, the shares in question can form a part of the net worth within the scheme and mandate of the Companies Act.
- Further court referred the case quoted by petitioner and observed that It is well settled that if the preference shares are not redeemed, the holder of the preference shares does not assume the status of a creditor.
- Further observed that even if O2 Power SG PTE. LTD is governed by the Indian Companies Act (which is actually not as it is a company incorporated in Singapore and is governed by the laws of Singapore), the preference shares issued by O2 Power SG PTE. LTD are not redeemable at the option of shareholders, and therefore, cannot be categorized as a debt.
- Court held that that the mode of calculation of net worth which has been adopted by the Respondents to exclude the Petitioner from further stages of the tendering process is contrary to the Sections of the Companies Act.
- Respondents cannot be permitted to adopt a method which runs contrary to the provisions. Even though there are no allegation of mala fides or that the method has been calculated to favour any particular party, since the decision has been arrived at in violation of the statute, this Court cannot be a party to uphold any decision which is contrary to the plain reading of the statute.
- Even if it were the case that the legality of the Impugned Decision was to be tested within directions laid down by Accounting Standard 32, it has been correctly pointed out by Mr. Mehta that in terms of AG 25 of the standards, the preference shares in question would be treated as a liability only in certain circumstances and not always.
- The Apex Court in a catena of Judgments has held that the scope of interference by the Courts in exercising jurisdiction under Article 226 of the Constitution of India in contractual matters is extremely limited. The Court interferes in contractual matters only when the decision-making process is faulty or that the decision arrived at by tenderer is calculated to favour somebody or that the decision is so irrational that no man of prudence would have come to that conclusion. In the facts of the present case, it cannot be said that the decision that has been arrived at by the Respondent is to favour somebody yet the method adopted by the Respondent for calculating net worth is contrary to the definition of net worth given under the Companies Act.
- The tenderer has decided to exclude preference shares from the definition of net worth on a wrong notion that preference shares is a liability which is contrary to the Sections in Companies Act.
- The Respondent is directed to re-work the net-worth of the Petitioner herein by including the preference shares while calculating its net-worth and take a decision as to whether the Petitioner's financial bid can be considered or not.
- The writ petition is allowed. Pending application(s), if any, are disposed of.

SEBI

Order of the SEBI Adjudicating Officer

Name of the Case: Adjudication order in the matter of Shilpi Cable Technologies ltd.

Facts of the case

The Shilpi cable technologies ltd. (hereinafter referred to as "SCTL") was listed on Bombay stock exchange (hereinafter referred to as "BSE") and National stock exchange (hereinafter referred to as "NSE"). The Company came out with an Initial Public Offer ("IPO") for issuance of 80,98,145 equity shares of face value ₹ 10/- each through 100% book building process at a price of ₹ 69/- per fully paid-up equity share (including a premium of ₹ 59/- per equity share) and aggregating to approximately ₹ 55.87 crore. On the day of listing i.e., 08th April 2011, on BSE scrip opened at ₹ 78.35/- and touched a high of ₹ 84.65 before closing at ₹ 47.60, registered a fall of 39.25. On NSE, it opened at ₹ 78.00/- and touched a high of ₹ 84.70/- before closing at ₹ 48.05/- and thereby registered a fall of 38.4% from the opening price. **SEBI had observed 19 such IPO in the year 2011 and SCTL was one of such 19 companies.**

Accordingly, Securities and Exchange Board of India ("SEBI") **Suo moto**-initiated investigation in the matter of IPO of the Company relating to bidding analysis, listing day analysis, trading analysis, utilization of IPO proceeds, deviation from objects mentioned in the final prospectus/ Red Herring Prospectus ("RHP") and violations of corresponding regulatory requirements by the Company. SCTL in its quarterly financial results to exchanges had disclosed IPO utilisation on quarterly basis. From transactions and SCTL's reply it was observed that IPO proceeds were utilised towards payment to 17 entities including Salasar Trading Company Limited ("Noticee No. 1" or "Salasar"), King Empire Tradexim Pvt. Ltd. ("Noticee No. 2" or "King Empire") and King Power Industries Pvt. Ltd. ("Noticee No. 5" or "King Power"), payment of IDBI Term Loan, Fixed Deposit Receipt with PNB and Other Expenses/ Payments. SEBI noted that **substantial portion of the IPO proceeds** were used to repay unsecured creditors, advances to a group entity – Shilpi Communications Pvt. Ltd, to the vendors who were subsequently selected by the Company to replace the vendors mentioned in the prospectus and working capital requirement.

SEBI observed that there has been **a stark deviation in the actual utilization of IPO proceeds** to that mentioned in the final prospectus. SCTL had deviated from the objects of the IPO by approx. ₹ **50 Crore**. Further, it was noted that **payments from the entire IPO proceeds** have been made during the period **April 07, 2011 to April 18, 2011**.

Pursuant to this examination Securities Exchange Board of India (hereinafter referred to as "SEBI") carried out investigation and observed that **businesses of the three entities** – Salasar, King Power and King Empire **are questionable**. Further, King Empire and King Power being incorporated in 2010 only and their revenue and sales did not commensurate with their meagre fixed assets, employee costs, etc. Since it is a fact that a **company** being a juristic person, **acts through its board of directors**, who individually and collectively hold the position of trust and have fiduciary duties towards the company, the shareholders and other stakeholders, Mr. Manoj Kumar Garg proprietor of Salasar, Mr. Om Raj Garg (Noticee No. 3) and Mr. Chandan Gupta (Noticee No. 4) of King Empire and Mr.Avnish (Noticee No .6) and Mr. Arvind Poddar (Noticee No. 7) of King Power being **directors , were also charged for violation of regulation**.

Charges levied

Noticees 1 to 7 have violated the provisions of Section 12A(c) of the SEBI Act, 1992 read with Regulation 3(d) and 4(1) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (hereinafter to be referred as "PFUTP Regulations"

Arguments by Noticee

- **Arguments about King power and Shri Avnish (Director):** Vide Summons, information was sought from King Power and its directors viz. Shri Avnish Bhatnagar (Noticee No. 6) and Shri Arvind Poddar (Noticee No. 7). According to submission by Shri Avnish, Mr. Manoj Garg's office misused his DIN and digital signatures without his prior consent and appointed him director in King power. The Contention of King Power was that he was not part of the fraud.

- **Arguments about King Empire:** Vide Summons, information was sought from King Empire and its directors Shri Chandan Gupta and Shri Om Raj Garg. However, letters sent to King Empire, Rrjr Trading Pvt Ltd and Shri Om Raj Garg were returned with the reason "Unclaimed." While, the letter to Shri Chandan Gupta returned with the reason "Addressee Moved."

- **Arguments of Shri Garg of Salasar Trading Company Ltd:** With regards to Shri Garg, he contended that he had never been associated or dealt with King Power, King Empire, Silver Jubliee Tradeexim Pvt Ltd, Western Alliance Tradeexim Pvt Ltd, Ford Asia Trading Pvt. Ltd. and Golden Jubilee Sales Pvt Ltd during the financial year 2010-2011 and 2011-2012. Mr Garg further contended that he was concentrating on his overseas business since 2007 so he was not fully aware of his business activities in India.

Contention of SEBI

- **SEBI's contention on arguments about King power and Shri Avnish (Director):** Regarding King Power, it was apparent from financial statements that it did not have any major fixed asset and it had an abnormally high level of inventory turnover. The Overall, the per unit price for the item of cable purchased by SCTL from King Power increased by almost 80% within a span of 6 months and also King Power was incorporated in April 2010 only, still SCTL placed substantial portion of its purchases with King Power during the period 2010-2012, which is suspicious in itself. With regards to Mr. Avnish, Noticee No. 6, who denied the fact of being director of the King Power. Instead, he had submitted that his DIN and digital signature, submitted for appointment as executive director of Frisco, has been misused by Mr. Manoj and his associates for appointing him as a director of their associate companies. In this regard, SEBI noted that the basis of association of Mr. Avnish with King Power is his signature on AOF of Axis Bank and the PoA submitted under his signature in favour of Mr. Manoj Kumar Mandal. Further, Mr. Avnish was a signatory to both the documents and a subscriber to the MoA and AoA of King Power and therefore, SEBI alleged that he was cognizant of his association with King Power.

- **SEBI's contention on arguments about King Empire:** With regards to King Empire which was incorporated in April 2010 which did not have any

major asset and had an abnormally high level of inventory turnover. Its ledger statement showed that SCTL and Shilpi Cabletronics had purchased goods worth ₹ 11.53 crore and ₹ 16.8 crore, respectively, and aggregating to ₹ 28.3 crore. Due to which SEBI inferred that SCTL and Shilpi Cabletronics were the only customers of King Empire during the FY 2010-11. There was also a lot of fluctuation in per unit price for connector purchased by SCTL from King empire within span of 6 months.

- **SEBI's contention on arguments of Shri Garg of Salasar Trading Company:** With regards to Salasar, it was a sole proprietorship hence no data was available in public domain However SEBI investigated ledger statements of Salasar and found that it had regular transactions with King Power, King Empire, Silver Jubliee Tradeexim Pvt Ltd, Western Alliance Tradeexim Pvt Ltd, Ford Asia Trading Pvt. Ltd. and Golden Jubilee Sales Pvt Ltd during the financial years 2010-11 and 2011-12. Also Mr. Garg's contention that he was not concentrating on business affairs in India and not in possession of any of the records sought relating to the transactions between Salasar and other entities to which SEBI informed him that **several financial transactions** were observed between him and the aforesaid entities during 2010-11 and 2011-12. Accordingly, SEBI asked him to provide details with respect to his relation with the entities and submit corroborating documents for such transactions for which he never replied. SEBI further contended that SCTL and Shilpi Cabletronics had transactions worth more than ₹ 100 Crore with Salasar, however, they **failed to provide the complete contact details of the employees from both parties who had dealt with such transactions**. Thus, SEBI took view that SCTL had deliberately not disclosed the complete details of such employees in order to prevent SEBI from contacting employees and to conceal such dubious transactions. Also, there was **commonality of email-ids** between Golden Jubilee Sales, Salasar, King Power and King Empire. SEBI observed that Salasar, King Empire and King Power are run by the same set of entities and connected to each other. Further, it is observed Shri Manoj Kumar Garg who is the sole proprietor of Salasar and was the promoter director of Golden Jubilee Sales. Also, during the financial year 2011-12, it is observed that **Golden Jubilee Sales had infused Rs. 99 lacs each in the share capital of King Empire and King Power**.
- **SEBI's Conclusion:** Hence SEBI concluded that the business credentials of Salasar, King Power and King Empire, with whom the SCTL was substantially purchasing the products during FY 2010-11 and 2011-12 is highly suspicious and dubious and whose credentials are questionable. Further, the funds through a series of transactions, were routed to outside of the country and in absence of any material stating otherwise on record, SEBI alleged that Salasar, King Power and King Empire acted as conduits for the transfer of IPO proceeds and being party to dubious transactions.

Penalty

Noticee	*Amount of Penalty*
Salasar Trading Company Limited (Proprietor - Manoj Kumar Garg)	15,00,000/- (Rupees Fifteen Lakh Only)
King Empire Tradexim Pvt. Ltd.	2,00,000/- (Rupees Two Lakh Only)
Mr. Om Raj Garg	2,00,000/- (Rupees Two Lakh Only)
Mr. Chandan Gupta	2,00,000/- (Rupees Two Lakh Only)
King Power Industries Limited	2,00,000/- (Rupees Two Lakh Only)
Mr. Avnish Bhatnagar	1,00,000/- (Rupees One Lakh Only)
Mr. Arvind Poddar	2,00,000/- (Rupees Two Lakh Only)

IBC

In the matter of *M/s. Punjabi Accessoriezz Private Limited (Applicant / Operational Creditor) vs. M/s. Kredo Beauty Private Limited (Respondent)* at National Company Law Tribunal (NCLT) New Delhi Bench dated 17th March 2023.

Facts of the Case

- M/s. Punjabi Accessoriezz Private Limited – Operational Creditor (OC) filed an application u/s 9 of the Insolvency and Bankruptcy Code, 2016 (IBC) for initiation of Corporate Insolvency Resolution Process (CIRP) against the Kredo Beauty Private Limited – Corporate Debtor (CD).
- The application was admitted by NCLT vide order dated 16th January 2020 and Mr. Ravi Bansal was appointed as the Interim Resolution Professional (IRP), who was further confirmed as the Resolution Professional (RP) of the CD.
- IRP constituted the Committee of Creditors (CoC). On comparison of the existing shareholding pattern of the CD with the Composition of CoC, it was found that the CoC members namely, Crickxon Trade & Export Private Limited and Swift Builders Limited were the shareholders of the CD.
- The application was filed by the RP of CD for approval of the resolution plan submitted by Ms. Vanshika Raheja jointly with Ms. Mridula Mangla - Resolution Applicants- (RA).
- The total claims of creditors/stakeholders admitted were to the tune of Rs. 382.98 Lakhs, against which the Successful Resolution Applicant (SRA) had proposed to pay Rs. 4.07 Lakhs only.
- The Financial Creditors (FC) were paid 0.99% only of their claim amounts.
- The Resolution Plan involved a haircut of 99% plus for the FC.
- The entire CoC of the CD consisted of its shareholders only. From the compliances in "Form-H", it wad observed that none of the two FC or the members of the CoC names are reflected under the category of "Unsecured Creditors in Column 2(a)", which meant that they were not considered as "related party" and therefore, they were not been debarred from the voting rights u/s 21(2) of the IBC.

- With this background - it was required to be examine that, if the CoC members, namely, M/s Crickxon Trade and Exports Private Limited and Swift Builders Limited, were unrelated parties of the CD.

Noting of the NCLT

- It was noted that the two CoC members hold a 19% voting share each. Therefore, individually they are not related parties to the CD in terms of Section 5(24)(j) of the IBC [*where related party in relation to a corporate debtor, means any person who controls more than 20% of voting rights in the corporate debtor on account of ownership or a voting agreement*]. However, in order to pass the test of being unrelated parties, the members of the CoC would have sail through all the criteria stipulated u/s 5(24) of IBC. Therefore, it is required to be examined if they are a related party under any of the other criteria stipulated u/s 5(24) of IBC.
- Another criterion to be considered for declaring a person as a related party to the CD, is stipulated u/s 5(24)(l) of IBC [i.e. *related party in relation to a corporate debtor, means any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor*].
- The aforesaid criterion implies that any person, who can control the composition of the board of directors of the CD is a related party to the CD. When it is said controlling the composition, it includes the appointment and removal of directors. In view of the above, NCLT examined, whether the two Shareholders/CoC members were in a position or legally capable to appoint or remove a director in the CD.
- To adjudicate removal and appointment of a director passing resolution by voting by show of hands NCLT examined the provisions regarding the removal and appointment of a director. First, it can be inferred from Section 169(1) of the Companies Act, 2013 (the Act) that an Ordinary Resolution is required to be passed by the Members/ Shareholders of the Company for the removal of a director.
- Similarly, the provisions for appointing directors are given u/s 152(2) read with 102 of the Act. The appointment of directors in place of those who are retiring is not considered a special business at the Annual General Meeting of the Company. In other words, the appointment of directors in place of those retiring is considered "an ordinary business", and an ordinary resolution is required to be passed for its approval.
- In order to perform various functions in a Company including appointment and removal of directors, the approval of shareholders is required in the form of an ordinary resolution or special resolution, as the case may be. The criteria for passing ordinary and special resolutions are stipulated under Section 114 of the Act.
- In order to pass an ordinary resolution, the assent of more than 50%, of members/shareholders of a company is required and for passing a special resolution, the assent of at least 75% of members/shareholders is needed. Section 114 of the Act further recognizes the terms "show of hands" and 'poll' as the voting criteria.
- In the normal course, the voting has to be done through the show of hands only, unless a Poll is demanded under

Section 109 of the Act, or the voting is carried out electronically.

- On comparison of the provisions relating to voting by poll with the voting by show of hands, it can be inferred that a voting by poll has to be specifically demanded u/s 109, and if voting through a poll was conducted, then in that situation, the votes of a member shall be in proportion to the paid-up capital held by them. In other words, the higher the paid-up capital held by a member/shareholder in comparison to other members, the higher would-be voting share. In contrast, voting by show of hand works on the principle of one member – one vote, irrespective of the percentage of paid-up capital held by the member in the Company.
- When NCLT revisited the section 114 of the Act, it was found that both voting by show of hands and voting by poll are recognized for passing of Ordinary and Special Resolutions. It goes without saying that the criteria of voting by show of hands is not excluded for the purpose of passing the resolutions.

Analysis of the NCLT

- NCLT analysed that:
  - — There are only 4 shareholders in the CD and both the Members of the CoC are from amongst them.
  - — To appoint or remove a director, an ordinary resolution is required to be passed.
  - — Voting by show of hands, is not excluded as a mode of voting for an ordinary resolution for either appointing or removing a director of the board.
  - — To pass an ordinary resolution by a show of hands, approval of more than 50% of the shareholders in number is required, which in the present case comes to 3.

Held

- If voting by show of hands would have taken place for passing an ordinary resolution for the appointment or removal of a director in the CD then the same would not have been possible without the participation of any of the CoC members.
- Therefore, the said two shareholders, who are also the members of the CoC of the CD, were capable of controlling the composition of the board of directors of the said CD. Hence, by virtue of their capability of controlling the composition of the board of directors of the CD, NCLT concluded that both the CoC members/CoC as a whole comprised of "related parties" to the CD in terms of Section 2(l) of IBC and therefore, the entire constitution of CoC was erroneous in the eyes of law.
- A resolution plan passed by a CoC, which is comprised of related parties of the CD, is void ab initio as it violates Section 21(2) read with Section 30(2)(e) of IBC.
- Accordingly, the application was dismissed. And since the maximum permissible period of the CIRP period has elapsed, the Liquidation of the CD was ordered.

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