[2006] 66 SCL 140 (CLB - NEW DELHI)

COMPANY LAW BOARD, PRINCIPAL BENCH, NEW DELHI

Union of India, Ministry of Company Affairs

v.

Padmini Technologies Ltd.

K.C. GANJWAL, MEMBER

CP NO. 2 OF 2003

MAY 30, 2005

Section 397 of the Companies Act, 1956 - Oppression and mismanagement - Government filed petition under section 397, read with section 408, alleging oppression and mismanagement in affairs of respondent-company and seeking appointment of directors by Government on board of company - Facts revealed that company incurred heavy loss by purchasing shares of a company at exorbitant rate which amounted to misuse of funds; that it had violated provisions of various sections of Act; that SEBI had conducted enquiries into affairs of company; and that creditors were also fighting case against company before Debt Recovery Tribunal - Further company entered into business with those companies which subsequently became vanishing companies and company had not made any efforts for recovery of money from those companies which resulted in loss to respondent-company - Majority of shareholding of respondent-company was held by members of public and stake of managing director and other members was far less - Whether on facts to safeguard interest of shareholders, public and company, Central Government was to be directed to appoint its directors on board of respondent-company - Held, yes

FACTS

The petitioner-Government filed a petition under section 397, read with section 408, alleging that the respondent-company incurred heavy loss by purchasing shares of a company at exorbitant rate of Rs. 130 and Rs. 160 per share when the nominal value of share was Rs. 10 only, which amounted to diversion and misuse of funds by the management of the respondent-company; that it had not raised money through non-convertible secured debenture; that it had neither created security of assets nor redeemed the debenture and no interest had been paid on those debentures as a result of which action was taken against the respondent
company before the DRT for recovery of dues; that the SEBI had initiated enquiry against the respondent-company as the company had manipulated the price movement by way of transfer of shares; and that the company had advanced loan to companies which were declared as vanishing companies by the SEBI and the respondent had not made any efforts to realize that amount. The petitioner contended that the company was not represented by majority of shareholders on the board of the company as majority of its shares were held by the general public and since the affairs of the company were managed in a manner which was prejudicial to public interest and the interest of the shareholders and creditors, the petitioner should be directed to appoint directors on the board of the respondent-company to safeguard the interest of the respondent-company and its shareholders.

HELD

Undoubtedly, the company had violated the provisions of many sections of the Act for which petitioners had taken appropriate action for compounding, etc., but that pointed out that the affairs of the company were being mismanaged which was prejudicial to the interest of the shareholders at large. SEBI had also conducted enquiries into the affairs of the company and they were also fighting case before the DRT. Although the company had tried to answer the allegations alleged in the petition but they had not been able to point out the reasons for losses. Similarly, they entered into business with those companies which subsequently became vanishing companies. The board of directors was duty bound to take action to recover money from those companies but it had decided not to file appropriate recovery suit which resulted in loss to the respondent-company. Moreover, the shareholding of about 70 per cent of the respondent-company was held by the members of the public. The stake of the managing director and other members was far less. The interest of the shareholder and public at large and company should be effectively safeguarded. Accordingly, the Central Government was to be directed to appoint two directors on the board of the respondent-company for the period of 2 years. [Para 10]

CASE REFERRED TO

Peerless General Finance & Investment Co. Ltd. v. *Union of India* [1991] 71 Comp. Cas. 300 (Cal.) (para 8).

Sanjay Agarwal and **Sanjay Shorey** *for the Petitioner.* **Krishna Kumar** *for the Respondent.*

ORDER

1. The Union of India through Secretary, Ministry of Company Affairs, Shastri Bhavan, New Delhi has filed a present petition against Padmini Technologies Ltd., having registered office at Dayanand Vihar, Delhi-110092 and its directors under section 397/398 read with section 401/408 of the Companies Act, 1956 seeking appointment of Government Directors on the Board of the Respondent Company. The Respondent Company was incorporated in 1990 as Padmini Packaging Pvt. Ltd. and its name was changed to Padmini Polymers Pvt. Ltd. dated 23-12-1992. Subsequently, the company was converted under section 44 as a Public Limited Company w.e.f. 2-2-1993 and company again changed its name from Padmini Polymers Ltd. to Padmini Technologies Ltd. w.e.f. 14-6-2000. The Respondent Company is a listed company in the Stock Exchange. The main objects of the company are to manufacture, weave, buy and sell, export and import and marketing of all kinds of packaging article made of all kind of plastic and plastic goods including plastic liners alongwith various activities. The company has made profits after tax of Rs. 4,047.55 lakhs as per Balance Sheet as on 30-6-2000.

2. The learned Counsel for Petitioner submitted that during the year 1999-2000 the Respondent Company invested Rs. 38.18 crores by purchasing 27,06,000 equity shares of Rs. 10 each of M/s. Shonkh Technologies Ltd., and un-listed company at the rate of Rs. 130 and Rs. 160 per share. There was no justification for acquiring shares of M/s. Shonkh Technologies Ltd. at exorbitant rate of Rs. 130 and Rs. 160 per share when the nominal value of share was Rs. 10 only. The company, therefore, incurred a loss of Rs. 38,09,99,999 in the purchase of 27,00,000 shares of M/s. Shonkh Technologies the above purchase of shares by investing Rs. 38.18 crores was by way of raising share capital of Rs. 20 crores by taking loans from IFCI amounting to Rs. 1,610.99 lakhs by issuing secured debentures of Rs. 850 to UTI. This amounts to diversion and misuse of funds by the management of the Respondent Company by making this worthless investment.

3. The learned Counsel for Petitioner further submitted that Respondent Company issued 8,50,000 non-convertible secure debentures of Rs. 100 each to UTI during the financial year ended 30-6-2000. The UTI *vide* their

letter dated 24-9-2001 informed that company has not furnished to them any document giving evidence of creation of security on its movable and immovable assets. UTI has initiated legal action against the Respondent Company before the Debt Recovery Tribunal, New Delhi for recovering their dues. The Respondents have not only raised the money through nonconvertible secured debenture but they have neither created security of asset nor redeemed the debentures. No interest has been paid on these debentures. This shows the intention of the management that the affairs of the company are conducted in the manner prejudicial to the public interest in general and shareholders and creditors in particular. Similarly, the company's annual accounts show unsecured loan from Air Force Group Insurance Society. The Air Force society approached this Board and an order of re-scheduling the payment was passed. Despite this, the company has not paid and cleared the dues of the society. The SEBI also in its report mentioned that transfer of shares from physical to demate has not been done by the company, the report also implicates that the company has manipulated the price movement by ailing the transfer of shares. Similarly, an advance of Rs. 1,10,45,47,190 was made to M/s. Kalayani Finance Ltd. in the year 2000 which has been declared as a vanishing company by the SEBI. The Respondent Company has not made any effort to realise this amount.

4. The Learned Counsel for Petitioner also pointed out that the company has delayed in depositing the statutory amount of provident fund, employees State insurance dues, sale tax and income tax etc. there is also violation of various sections of the Companies Act such as 383A, 58A, 209(1)(*d*), 211 read with Schedule VI, 301, 147, 150, 418 of the Companies Act for which the prosecution has been filed in the court on 16-3-2002.

5. The learned Counsel for Petitioner further submitted that Sh. Vivek Nagpal is the Promoter Director of the Respondent Company. He is holding 9.54 per cent shares and he is controlling the affairs of the company as Chairman-*cum*-Managing Director. The general public is holding 69.65 per cent shares in this company. It shows that the company is not represented by majority of shareholders on the Board of the Company. The facts and circumstances relating to the affairs of the Respondent Company clearly established that its affairs are managed in a manner which is prejudicial to public interest and is also prejudicial to the interest of the shareholders and creditors. It is apprehended that if the assets of the company are not protected forthwith being diverted or sold in any manner, a serious prejudice is caused to the public interest. The Petitioner, therefore, prayed that on the basis of facts and circumstances of this case, the Petitioner/Central Government be directed to appoint four Directors on the Board of Directors of Respondent Company for a period of 3 years to effectively safeguard the interest of the Respondent Company and its shareholders as the winding up of the company would unfairly prejudice the members but otherwise the facts of the case would justify making of winding up of order on the ground that it is just and equitable that the company should be wound up.

6. The learned Counsel for Respondent in reply submitted that all the issues raised by the Petitioner were false and have been raised mechanically without application of mind or understanding of the subject-matter. The allegations that the company had incurred a loss of Rs. 38 crores in the sale of shares of M/s. Shonkh Technologies Ltd. is incorrect. The statement of details of transaction would revel the fact that the company had registered a profit of Rs. 25,88,728. It is apparent from the statement 27,06,000 shares of Shonkh Technologies Ltd. were acquired at a cost of Rs. 38,17,80,000 as part of an overall arrangements in which the company received bonus shares in lieu of transfer of business undertaking of Shonkh Technologies Ltd. to Shonkh Technologies International Ltd. The transactions of sale of shares of Shonkh Technologies Ltd. being part of

composite deal by getting bonus shares without having made any payment, the Respondent Company got profit in the transaction to the extent of Rs. 25,88,728. The justification for acquiring the shares of M/s. Shonkh

Technologies Ltd. at Rs. 130 and Rs. 160 per share being exorbitant is baseless as the shares at that point of time were being purchased at a rate of Rs. 400 per share. For illustration, it may be pointed out that SBI Mutual Fund *vide* their letter dated 2-3-2000 address to Shonkh Technologies Ltd. were agreeable and keen to apply for 14 lakh shares at the rate of Rs. 400 per share whereas the Respondent Company had purchased only at Rs. 130 and Rs. 160 per share. Regarding the allegations UTI inform that the company is defaulting in redemption of debenture and payment of interest thereon is the subject-matter of proceedings before the debt recovery Tribunal and the same is not being agitating here as the Respondent Company has filed an interim reply before the said Tribunal. In any case the pendency in claim made by UTI does not in any way relate to the relief sought for in the present petition.

7. The Learned Counsel for Respondent submitted that issue raised with regard to Air Force Group Insurance Society is no longer relevant. The matter has been duly settled and the settlement has been recorded in the proceeding before the High Court of Delhi at New Delhi. Parities have already acted on the basis of settlement and no further action is called for. The Petitioner has not even referred to settlement deed and the payments made therein. As regards loans IFCI, an amount to the extent of Rs. 1,610.99 lakhs for the purchase of imported DVD plant of the company, the allegation is baseless. The Loan from UTI and IFCI was not utilized for the share capital of Shonkh Technologies Ltd., as alleged. This amount had been made by way of irrevocable letter of credit executed by IFCI in favour of suppliers namely Toolex Europe at Netherland. The company therefore had never received any amount directly from IFCI and the question of said fund being diverted would not arise. The allegations pertaining to Kalyani Finance Ltd. are based on presumption. During the years 1995-96 and 1996-97 the Respondent Company sold software to M/s. Kalyani Finance Ltd. There was an outstanding balance of Rs. 10,45,47,190 to be recovered from Kalyani Finance Ltd. and as was shown as debtor in the balance sheet as on 30-6-1997. The said amount was later on transferred from debtors to advance from capital good while preparing the balance sheet for the year 1998. Copies of the extract from the ledger of the Respondent Company pertaining to M/s. Kalyani Finance Ltd. have been placed on records. In normal course of business, M/s. Kalyani Finance Ltd. would not be set to be a vanishing company. The Respondent Company supplied softwares from time to time to M/s. Kalyani Finance Ltd. which in turn also carried out modification and such supplied modified version of the software. The values in the transaction, therefore, represent a broad value of the software and not the fianlized value. Therefore, the transaction by no stretch of imagination, would be set to be abnormal. The total transaction works out more than Rs. 29.04 crores and M/s. Kalyani Finance Ltd. has only supplied Rs. 13.92 crores and also paid money to the tune of Rs. 4.67 crores through Bank, which resulted in the profit of the company. After the slump in the IT market in 1998, the values of the software declined drastically and there was heavy loss incurred by M/s. Kalyani Finance Ltd. It is pertinent to note when the industry was doing well, the Respondent Company generated substantial profit which could be attributed to the transactions the company had with M/s. Kalyani Finance Ltd. It was not advisable to initiate any proceedings for recovery as the company would have had to pay heavy court fees to the extent of more than Rs. 90 lakhs and there was no necessity for the company for have indulged in a proceeding which involves spending of good money in courts for amounts which could not

in any event recovered in spite its best efforts. The company had taken advice of the Consultant and lawyers and therefore, consciously not filed any suit. The other allegations that the company did not comply with the statutory requirement/delayed in depositing statutory amounts and have violated the provision of Companies Act have been mentioned without appreciating the totality of the facts. The company has already made appropriate application for delays and technical violations to the concerned authority for compounding the offence under sections 209 and 418 of the Companies Act for which appropriate orders have been passed by the concerned authorities. By referring to some of the letters said to have been written by IFCI the Petitioners are attempting to distort the true facts. There are no proceedings pending against the company as on date, which may require any action including penal action. The Board of directors of the company is having two nominees of IFCI and UTI. The constitution of the Board is prerogative of shareholders and there is no complaint by any of the shareholder that the Board has not been constituted properly.

8. The learned Counsel for Respondent further submitted that matter pertaining to transfer of shares and conversion of physical to demate, the same have been done in accordance with normal procedure followed by the industry. In any event the matter pertaining to these transactions are subject-matter of enquiry by SEBI which cannot be made a ground for any enquiry under sections 397, 398, 402 and 408 of the Companies Act, 1956. All the allegations made in the petition are baseless. No case has been made out for exercising the extraordinary power of the Company Law Board under section 408. The learned Counsel also relied on the judgment in the matter of *Peerless General Finance & Investment Co. Ltd.* v. *Union of India* [1991] 71 Comp. Cas. 300 wherein the Calcutta High Court held that the power under section 408 cannot be lightly exercised, inasmuch as it affects the rights of the Board of Directors to run the affairs of the company under the ordinary law. Such action cannot be allowed to be taken on the basis of mere speculative findings. Moreover, the powers under section 408 can be exercised only if the company's conducting its affairs prejudicially and they are sufficient evidence on records. The meaning of word, satisfy means that there should be sufficient evidence and beyond reasonable doubts, objectively not subjectively. The present *Union of India* v. *Padmini Technologies Ltd. (CLB - New Delhi)* petition is only made on speculation and without appreciation of subjectmatter. As such the petition be dismissed with exemplary cost.

9. In rejoinder reply, the Learned Counsel for Petitioner submitted that the Respondents have given fake and evasive reply even SEBI has informed that the share price of Padmini was manipulated to facilitate off loading of shares at a higher price. Unit Trust of India has also stated in their letter dated 24-9-2001 that the company had not furnished to them any document evidencing creation of security on its movable and immovable property. The roles of nominee directors are to have the interest of financial institution protected. Nominee Director is not required either to perform or to interfere in day-to-day business and affairs of the company. Ministry of Company Affairs have also clarified *vide* their circular dated 20-9-1973 that no proceedings against the nominee director of financial institution should be initiated as he had no active role in the management of the day-to-day business and affairs of the company. The mere fact the SEBI is looking after certain allegations does not debar the Board to act under section 408 of the Companies Act. It is a fit case where this Board should exercise powers under section 408 and allow the appointment of Government Director on the Board of Respondent Company, as prayed.

10. I have considered pleadings of this case as well as heard the Learned Counsels for both sides. Undoubtedly, the company has violated the provisions of many sections of the Companies Act, 1956 for which Respondents

have taken appropriate action for compounding, etc., but this points out that the affairs of the company are being mismanaged which is prejudicial to the interest of the shareholders at large. SEBI has also conducted enquiries into the affairs of this company and they are also fighting case before the Debt Recovery Tribunal. Although the company has tried to answer the allegations alleged in the petition but they have not been able to point out the reasons for losses. Similarly, they entered into business with those companies which subsequently became vanishing company. The Board of Directors was duty bound to take action to recover money from M/s. Kalyani Finance Ltd. but they decided not to file appropriate recovery suit which resulted in loss to the Respondent Company. Moreover, the shareholding of about 70 per cent of the Respondent Company is held by the members of the public. The stake of the Managing Director and other members is far less. The interest of the shareholder and public at large and company should be effectively safeguarded. Accordingly, the Central Government is directed to appoint two directors on the Board of the Respondent Company for the period of 2 years.

11. With above directions, the petition stands disposed of. There are no orders as to cost.

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