

*

IN THE HIGH COURT OF DELHI AT NEW DELHI

Date of Reserve: May 21, 2009

Date of Order: July 01, 2009

+ OMP 180/2008

%

01.07.2009

CHIC-TEX INC

...Petitioner

Through : Mr. Rajiv Nayar, Sr. Adv. with Ms. Ruchi Agnihotri
Mahajan and Ms. Anisshree Tripathi, Advs.

Versus

SUPREME TEX MART LIMITED & ORS.

...Respondents

Through: Mr. Chetan Sharma, Sr. Adv. with Mr. Arun Francis &
Mr. Rajeev Mishra, Advs.

JUSTICE SHIV NARAYAN DHINGRA

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

JUDGMENT

1. This application under Section 9 has been made with following prayers:

“A. Restrain the respondent no. 1 company from diluting the petitioner company’s equity holding of 11% in the respondent no. 1 company.

B. Restrain the respondent no. 1 company from passing any resolution at the Extraordinary General Meeting of shareholders scheduled for 29th March, 2008 in furtherance of proposed allotment of equity capital on a preferential or other basis to a third party and in particular to M/s. Sinochamp Corporation Limited.

C. Restrain the respondents from engaging in any activity or business which is in competition with or directly or indirectly similar to that of the CTI-SYL

Division of the respondent no. 1 company to pass ad-interim orders as prayed for above;

D Restrain the respondent from exporting hand knitting yarn except through the CTI-SYL Division of the respondent no. 1 company and in terms agreed under the Distribution Agreement;

E. Restrain respondent nos. 3, 4 and 5 from taking any action to siphon off monies/funds of the respondent no. 1 company and diverting the same to respondent no. 2;

F. Restrain the said respondents from taking any actions by which clients of the petitioner and/or respondent no 1 are diverted to respondent no.2;

G. Direct respondent no. 1 to maintain status quo on shareholding which would be just and equitable in the facts and circumstances of this case.”

2. The brief facts relevant for purpose of deciding this application are that the petitioner entered into an Investment Agreement with the respondent on 2nd May, 2007. The agreement between the parties was signed at Ludhiana. By this agreement, the petitioner and the respondent had agreed to create a joint venture for setting up a Hand Knitting Yarn Division to be known as CTI-SYL Division. The petitioner was to provide technical knowhow for manufacture, operation, management and production of hand knitting yarn and was to train personnels of the respondent for marketing and sales in order to achieve the goal of increasing revenue of the division. The division was to be controlled through a joint management committee of petitioner and respondent no. 1. The petitioner was to invest 3 million US\$ into respondent no.1-company for purchase of its 11% shares, each share having a face value of Rs.5/- . The shares were to be issued to the petitioner at a price of either Rs.32/- or the price

which may be determined for preferential allotment of shares as per SEBI Rules, whichever was higher. Any shortfall in the price of 11% equity shares from 3 million US\$ was to be made-up by the petitioner. The Investment Agreement provided that in case the petitioner paid the amount but the shares were not allotted, the petitioner would earn 8% per annum interest after 60 days of the sending of the money and shall be entitled to seek refund of the money. The Investment Agreement contained several clauses in respect of the equity holding of the petitioner in respondent no.1-company. The relevant clauses are as under:-

“2.14 In the event that the shares of SYL shall be diluted due to raising of equity interest and capital in the Corporation, the equity Shares of SYL held by CTI shall not be diluted, without the approval from the Management Committee of the CTI-SYL Division.

2.15 In the event that CTI decides to dilute its Shares of the Corporation to below 50% of the Shares allotted to it, the Corporation shall review the nomination of the Directors allotted to CTI on the Board of Directors of SYL based on the amount of dilution of its Shares, to which shall be decided unanimously with the consent of the Board of Directors of the CTI-SYL Division.

2.16 Out of the Shares allotted to CTI against the Investment, CTI shall be entitled to transfer/sell on the stock exchanges up to 15% of the total number of Shares in any financial year, without any restriction or lock in period whatsoever, except as may be applicable under law. Any sale of shares in a financial year beyond the aforesaid limit shall be subject to a right of first refusal in favor of promoters of SYL, namely Mr. Ajay Gupta and Mr. Sanjay Gupta.

2.17 In the event CTI dilutes its shareholding in SYL to below 50% of the number of Shares issued and allotted to it against the investment within the first five(5) years from the date of execution of this

Agreement, the exclusive rights for International markets provided to CTI by the CTI-SYL Division shall cease.

2.18 In the event that the Directors, Officers, Representatives and/or Associates of SYL intend to dilute their shareholding in SYL to less than 51% of the issued and paid up capital of SYL or to sell their shareholding such that they cease to be in management of SYL, SYL shall immediately inform CTI in writing as soon as reasonably possible of the intentions of SYL and CTI shall have tag along right in respect of its shares in such sale.

2.19 In the event that the Directors, Officer, Representatives and/or Associates of SYL sell their shareholding in SYL to less than 51% of the issued and paid up capital of SYL, SYL shall grant to CTI a right of first refusal to buy the issued and paid up capital shares that SYL intends to sell at fair market value as mutually agreed between the Parties.

2.20 In the event that CTI does not manifest its intention to buy the said shares of SYL within ninety (90) days of being informed of the sale of shares by SYL, SYL may sell the shares to any third party.

2.20 In the event that the shares of SYL are sold to a third party, CTI shall have the right but not the obligation to dilute its own Shares of SYL without penalty, irrespective of any clauses in the present Agreement that run in contradiction with the dilution of the Investment of CTI of its Shares within SYL and reserves its right to terminate said Agreement.

2.21 In the event that the shares held by the Directors, Officers, Representatives and/or Associates of SYL are diluted and/or are sold to a third party, the equity shares of CTI representing an eleven percent (11%) equity in SYL shall under no circumstances be affected or reduced due to the dilution of shares of SYL by the Directors, Officers, Representatives and/or Associates of SYL."

3. Apart from the above clauses regarding equity shareholding of the petitioner, the Investment Agreement also contained provisions regarding management and operation of the CTI -

SYL Division, provisions for purchase of equipments, management and supervisory directions, marketing and sale directions, international marketing, gross selling of products, keeping of books of accounts and records of CTI-SYL Divisions, funding and sharing of profit and losses. The Investment Agreement also contained restrictive covenant of non-competition.

4. The agreement contained an Arbitration Clause providing that in case of disputes or differences, the efforts shall be made first to resolve them through negotiation and settlement and in case no amicable settlement is arrived at within 15 days, then such a dispute or difference shall be referred to a mutually acceptable single Arbitrator, the arbitration proceedings to be held in Delhi under the Arbitration and Conciliation Act, 1996.

5. The petitioner's contention is that after entering into this agreement, the respondent no.1 did not discharge its liability under the agreement and did not adhere to the basic norms of industry and dispatched a shipment which was completely at variance with technical standards demanded by the petitioner's order, resulting into loss of important client of the petitioner. Thereafter the respondent failed to adhere to the shipment dates in respect of another order, though the same were critical to the business. The shipment was to be dispatched within or by 15th June, 2007, but respondent no. 1 sought to extend the shipment dates by 2 months. The petitioner contended that similar problems regarding other shipments led to tremendous

loss, inconvenience and erosion of petitioner's customer confidence and damaged the reputation of the petitioner's company. It is also submitted that the respondent no.1 acted in direct conflict with the interest of joint venture company by operating a semi-associated company in its premises, that manufactured and sold yarns in the local/outside market. He submitted that as per Investment Agreement, production was scheduled to begin on 31st July, 2007, but the facilities as contemplated were not set up to commence production and shortcomings were notified to the respondent by the petitioner in early October, 2007.

6. In August, 2007, the respondent no.1 intended issuing a rights issue to which petitioner protested and stated that rights issue shall dilute the shareholding of the petitioner to 8.29% and will be in violation of the terms of Investment Agreement. In September, 2007, the petitioner entered into a Distribution Agreement with the respondent no. 1 and Venus woolen mills. This Distribution Agreement was also violated by the respondents in October, 2007. Petitioner's CEO travelled to Ludhiana in good faith to present himself as a Director for a board meeting of respondent no.1 scheduled for 9th October, 2007. This board meeting was suddenly adjourned without any justification, with the result that petitioner's President could not participate in the board meeting. The board meeting was adjourned indefinitely and it was held in 28th December, 2007, i.e, in the middle of Christmas vacations.

7. The petitioner had narrated several instances showing that the Investment Agreement was not being followed by the respondent no.1 in a true spirit. On 29th November, 2007, M/s. Dua Associates sent an e-mail message on behalf of the petitioner to Mr. Ajay Gupta, a Director of SYL and brought it to the notice of Mr. Ajay Gupta that the respondent was not proceeding in accordance with the Investment Agreement and there were outstanding issues. The respondent was asked to settle outstanding issues and a meeting was held for this purpose on 5th December, 2007

8. The parties had been exchanging correspondence through e-mails. An e-mail was received by the petitioner on 29th February, 2008 informing the petitioner that a board meeting of the respondent company will be held on 4th March, 2008 to consider the issue of equity shares on preferential basis to Sinochamp Corporation Ltd. It is submitted by the petitioner that without a proper notice to the petitioner and in violation of the Investment Agreement dated 2nd May, 2002, the respondent no.1 proceeded to convene a board meeting to pass a board resolution to negotiate the process for issuance of equity shares to Sinochamp Corporation Ltd., Hong Kong on preferential basis, subject to approval of shareholders. It is after learning of this board meeting that the petitioner approached this Court under Section 9 with the above prayers.

9. The contention of counsel for the petitioner is that under no circumstances, the petitioner's equity could be diluted below 11% in

respondent-company. The Investment Agreement is to continue for a period of 5 years and this would come to an end only in 2012 and upto 2012 the shareholding of the respondent no.1-company, SYL has to be such that the petitioner holds 11% equity shares in the respondent-company.

10. The respondent submitted that this Court had no territorial jurisdiction to entertain the application of the petitioner under Section 9 of the Act. The agreement between the parties had taken place in Ludhiana. The respondent's office was at Ludhiana. The petitioner was a company of Canada. The joint venture factory was situated in Ludhiana. Manufacturing was taking place at Ludhiana and the only Court which had jurisdiction would be Court at Ludhiana and the Court at Delhi would have no jurisdiction. He also submitted that the respondent no.1 during pendency of the petitioner had offered to the petitioner preferential shares in such a manner that the equity of the petitioner remains 11%. It was for the petitioner to take up these additional equity shares so that its equity remains 11%. The respondent had no intention to dilute the equity of the petitioner. It is the petitioner who did not accept the offer and has not subscribed to the preferential shares. Under these circumstances, the respondent cannot be restrained from issuing preferential shares to other companies.

11. It is to be considered whether clause 2.21 stated above is an absolute clause sacrosanct to the Investment Agreement, and

under no circumstance the equity of the petitioner can be reduced below 11%.

12. A perusal of other clauses of agreement shows that clause 2.21 is not sacrosanct and the equity of the petitioner can go below 11% under many circumstances. Clause 2.14 (supra) provided that SYL can raise the equity interest and capital in the corporation and in such an event the equity share of SYL held by CTI shall not be diluted without approval of the management. If additional equity is issued to raise the capital there is no way by which petitioner's share of 11% in the total equity of the respondent no.1-company can remain undiluted, unless the petitioner is offered, out of the additional shares, 11% shares for subscription and the petitioner subscribes to this additional equity. It is only then that the equity of the petitioner would remain intact to 11%. This clause shows that there was a scope of raising of equity, but the only condition was that the equity of the petitioner should be 11%. Clause 2.15 (supra) shows that the petitioner can dilute its equity in respondent no.1 even below 50%. Clause 2.16 of this agreement shows that the petitioner had taken liberty to sell part of its equity in the open market and had liberty to dilute its shareholding in the respondent no.1-company below 50% of the share allotted to it. Thus, clause 2.15 and 2.16 show that the equity of the petitioner can be divested by the petitioner from 11% to 5.5% without any consequences and it is only when it goes below 5.5% that the corporation has to review the nomination of Directors allotted to the

petitioner. Clause 2.16 gives right to the petitioner to sell its shares on Stock Exchanges upto 15% of the total number of shares in any financial year and Clause 2.17 again provided for dilution of the equity of the petitioner by the petitioner. Clause 2.18 gives right to the respondent and its officers and representatives to sell their shareholdings but it provides that in case they dilute their shareholdings in SYL to less than 51% of the issued paid-up capital then SYL shall inform the petitioner in writing. Clause 2.19 provides that in case, the representative, officers and directors intend to sell their shareholdings in SYL so as bring it to less than 51% of the paid-up capital, they shall grant to the petitioner a right of first refusal to buy the issue and paid-up capital shares.

13. A perusal of different clauses of agreement shows that clause 2.21 was not sacrosanct to such an extent that the respondent cannot increase its share capital and cannot issue additional preferential share or right shares. The only condition put is that the equity of the petitioner should fall below 11%. For this as provided in other clauses, it would be necessary for the respondent to offer to the petitioner 11% shares out of the additional equity so that on subscribing to additional shares the equity of the petitioner is maintained at 11%. The petitioner always had a right under the agreement to reduce its equity. The petitioner can exercise its option either to purchase the shares or not to purchase the shares so offered. I therefore consider that once, the respondent had offered additional

shares to the petitioner out of preferential or right issue, the liability of the respondent is over and the petitioner cannot say that the respondents should be stopped from increasing the share capital of the respondent no.1-company at the risk and cost of its business or expansion plans. The respondent no.1 is a company independent of the Investment Agreement. The expansion of share capital of the respondent no.1 as per law can be permitted, subject to the terms and conditions stated in the Investment Agreement and the perusal of entire Investment agreement shows that the respondent no.1 had to offer shares to the petitioner so that the petitioner can choose whether it has to maintain this equity at 11% level or not. I therefore consider that no injunction can be granted against the respondent from issuing preferential shares to other parties so long as the respondent is prepared to offer 11% of the additional share to the petitioner.

14. I also consider that this application under Section 9 could not have been filed in Delhi because no cause of action had arisen in Delhi. The parties entered into agreement in Ludhiana, the subject matter of the agreement is situated at Ludhiana. Merely because the parties had chosen to have arbitration in Delhi would not invest Delhi Courts with jurisdiction. Delhi Court can have jurisdiction only if it is a proper Court under Section 2(1)(e) of the Act. This Court held in ***M/s. Pacific Green Infracon Pvt. Ltd. vs M/s. Senior Builders Ltd.*** as under:-

“Under the Arbitration Act, the parties are at liberty to choose as to who will be the Arbitrator to adjudicate the disputes for them, what will be the place of arbitration. There is no restriction on the parties in choosing these two factors, i.e., Arbitrator and the place of arbitration and the parties can even choose what will be the law applicable. If one party is the Indian party and the other is a foreign party, the parties can choose whether the Indian law will be applicable or the foreign law will be applicable. But the parties cannot by mutual consent confer jurisdiction on a Court which otherwise does not have jurisdiction. Merely because the parties have chosen the place of arbitration as Mumbai, Chennai, Delhi or Kolkata, it would not mean that the Courts at Mumbai, Chennai, Delhi or Kolkata will have jurisdiction in respect of application filed under Section 9. In order to decide an application under Section 9, the Court where application is made must have jurisdiction taking into account the subject matter of the application. Section 2(1)(e) read with Section 9 of the Arbitration Act makes it clear that in order to have jurisdiction to decide an application under Section 9, the Court entertaining the application should be the Court which has power to entertain the suit on the facts as mentioned in the application under Section 9, and the Court is competent to give relief in a suit.”

15. I therefore consider that the present petition filed by the petitioner is not maintainable on the ground of jurisdiction as well as on merits. The petition is hereby dismissed.

July 01, 2009
ak

SHIV NARAYAN DHINGRA J.