

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

COMPANY PETITION NO. 404 OF 2016

Aditya Prakash Entertainment Pvt. Ltd.

.. Petitioner

Vs.

Magikwand Media Pvt. Ltd.

.. Respondent

Mr.Amir Arsiwala a/w. Mr.Raghav Shekhar i/b The Law Point for petitioner.

Mr.Rohan Sawant a/w. Ms.Monisha Mane-Bhangale and Ms.Warisha Parkar
i/b ALMT Legal for respondent.

CORAM : K.R.SHRIRAM, J.

DATE : 5TH MARCH 2018

P.C.

1. The petition has been filed by petitioner for winding up of the company-Magikwand Media Ltd. (the company). Though in the cause title, it is mentioned, '*In the matter of Section 433(f) and 434 of the Companies Act*', Shri Arsiwala appearing for petitioner started by saying it is under Section 433(e), namely, the company is unable to pay its debt.

2. Petitioner had subscribed and had issued 1,00,078, 6% non-cumulative optionally convertible redeemable preference shares of Rs. 10/- each. As a shareholder, for each financial year, petitioner was entitled to non-cumulative preferential dividend of 6%. Preference shares issued was with a conversion option under which petitioner could, in lieu of redemption, exercise the option for conversion of preference shares into

equity shares between 1st October 2014 to 31st December 2014 in one or more tranche by giving prior notice to the company of not less than 60 days in writing. One preference share is to be converted into ten equity shares of Rs.10/- each. The Board also had option to convert the preference shares partly or fully in equity shares of the company with the consent of the petitioner on mutually agreed terms and conditions even before 1st October 2014. Redemption schedule was also provided whereby Rs.30/- per share was to be paid out on 28th February 2015, Rs.35/- per share on 28th February 2016, Rs. 35/- per share on 28th February 2017. Admittedly, petitioner did not exercise its option to convert the preference shares into equity shares and admittedly, the company also did not exercise its option to convert preference shares partly or fully into equity shares.

3. At no point, the company declared any dividend even to the equity shareholders or preferential shareholders. At the time when this petition came to be filed, only the first redemption had become finally due, i.e., redemption due on 28th February 2015 at Rs. 30/- per share. During the pendency of this petition, the other two installments have also fallen due. Effectively, the entire amount of Rs.1,00,07,800/- has become due and payable.

4. It is petitioner's case that despite being called upon to pay the

redemption amount, the company failed and neglected to pay. Petitioner has also relied upon the annual accounts of the company for the period F.Y. 2012-13 upto F.Y. 2015-2016 to say that the company's net-worth has eroded. Shri Arsiwala submitted that except during the year 2013-14, when the company showed a profit of Rs.72.92 lakhs, at no other time has the company made any profit. Shri Arsiwala further submitted that during the financial year 2013-14, though the company had shown a profit of Rs.72.92 lakhs, its net-worth was (negative) Rs.1,18,06,604/- and in the following F.Y. 2014-15 the net-worth had gone down further to (negative) Rs.1,52,85,165/-. The counsel also relied upon the annual returns filed for F.Y. 2015-2016 to submit that the number of business activities of the company is shown to zero, turnover is zero and the net-worth was (negative) Rs.1,92,47,658/-. Shri Arsiwala submitted that the company, therefore, could be held to be unable to discharge its debts, commercially insolvent and wound up.

5. Shri Sawant appearing for the company, at the outset, submitted that the petition is not maintainable. Though in the cause title, petitioner has mentioned *"In the matter of Section 433(f) and 434 of the Companies Act, 1956"* and in paragraph 19 of the petition it is stated *'Strictly without prejudice and in addition to the above, petitioner states that Respondent Company is liable to wound up under Section 433(f), i.e., for the*

loss of its substratum', in Paragraph 31 of the petition, petitioner has framed its intention as to how it has approached this Court, i.e., '*petitioner has approached this Court as a creditor and not as a shareholder*'. It will be useful to reproduce paragraph 31 of the petition :

"31 The Petitioner states that it is also in the process of initiating appropriate legal action against the Respondent Company for violation of the Petitioner's rights as a shareholder. The Petitioner states that the present Petition seeking winding up of the Respondent Company is being filed by it in the capacity of a creditor and not as a shareholder. The Petitioner craves leave to refer to and rely upon the said legal proceedings as and when the need arises."

(emphasis supplied)

6. Shri Sawant submitted that as provided under Section 80 of the Companies Act, 1956, no such shares can be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. Counsel also submitted that a preference shareholder is the shareholder of the company and cannot style itself as creditors and therefore, petitioner has no *locus standi* to maintain the petition. Counsel submitted that if payment is made other than from the profits of the company which would be available for dividend or out of the proceeds of a fresh issue of shares made for the purpose of redemption, it would amount to a fraud on the creditors of the company. Shri Sawant relied on judgments of (i) Andhra Pradesh High Court in ***Lalchand Surana & Ors.***

Vs. M/s. Hyderabad Vanaspathy Ltd., Moulali, Hyderabad¹; (ii) of a

¹ 1990 (68) Company Cases 415

Division Bench of this Court in *State Bank of India & Ors. Vs. Alstom Power Boilers Ltd. & Ors.* ²; (iii) *Hindustan Gas and Industries Ltd. Vs. Commissioner of Income-tax, West Bengal-II* ³; and (iv) *National Co-operative Development Corporation Vs. Assistant Commissioner of Income Tax, Circle 13(1)* ⁴.

7. Shri Arsiwala relied upon *Anarkali Sarabhai, Shahibag House, Ahmedabad Vs. Commissioner of Income Tax, Ahmedabad* ⁵ to submit that the redemption of preference shares is only sale of the shares back to the company and therefore certainly the petition is maintainable.

8. Before we proceed further, it will be helpful to reproduce Section 80(1) of the Companies Act, 1956 which reads as under :-

“Section 80(1) : Power to issue redeemable preference shares:

(1) Subject to the provisions of this section, a company limited by shares may, if so authorised by its articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed:

Provided that-

(a) no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption;

(b) no such shares shall be redeemed unless they are fully paid;

² 2003 SCC OnLine Bom. 321

³ 1978 SCC OnLine Ca.410

⁴ 2011 SCC OnLine Del. 5029

⁵ (1997) 3 SCC 238

(c) the premium,, if any, payable on redemption shall have been provided for out of the profits of the company or, out of the company' s share premium account, before the shares are redeemed;

(d) where any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall, out of profits which would otherwise have been available for dividend, be transferred to a reserve fund, to be called the capital redemption reserve account], a sum equal to the nominal amount of the shares redeemed; and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the capital redemption reserve account] were paid- up share capital of the company.”

9. In this case, there is no dispute to the fact that petitioner was a shareholder holding preferential redeemable preference shares. The only question that requires to be considered is whether petitioner would be a creditor of the company. Sub-section 1 of Section 80 says, subject to the provisions of this section, a company limited by shares may, if so authorised by its articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed. Proviso, however, states that no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. This aspect, in my view, shows that 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 character of a "creditor". The reason is that his shares can be redeemed only out of the profits of the company

which would otherwise be available for dividend, or by afresh issue of shares. This is a limitation which is not applicable to any other creditor of the company. The shareholders of redeemable preference shares of the company do not become creditors of the company in case their shares are not redeemed by the company at the appropriate time. They continue to be shareholders, no doubt subject to certain preferential rights mentioned in Section 85 of the Companies Act, 1956. If they do not become the creditors of the company, they cannot apply for winding up of the company under Section 433(e) of the Companies Act, 1956.

9. A Division Bench of our Court while considering *SBI Bank of India* (supra) whose facts were different, has opined that preference shareholders cannot be called 'creditors' to attend the meeting of the creditors of the company to be held under Section 391 of the Companies Act, 1956. Paragraph 25 of the said judgment reads as under :-

"25 The right given under clause (b) of Sub-section (2) is "to vote on every resolutions placed before the company at any meeting." In our opinion, the words "before the company at any meeting" refer to a meeting of the company i.e. a meeting of the members of the company. A meeting of outsiders like the creditors of the company is not a meeting of the company. It is a special type of meeting of outsiders for a special purpose under Section 391 of the Act. Section 165 to 197 of the Act grouped under the heading "Meetings and proceedings" in Chapter I of part VI of the Act contain certain provisions relating to the meetings. They also regard only the meetings of the members of the company (as opposed to the meetings of outsiders like creditors) as the meetings of the company. Another clue to this interpretation can be found by reference to clause (c) of

subsection (2) of Section 87 which lays down that the voting right of a holder of preference share who has a right to vote under Sub-section (2) shall be in the same proportion as the capital paid up in respect of the preference share bears to the total paid up equity share capital of the company. For the purpose of determining the value of the vote cast by a preference shareholder, one has to find its proportion to the total paid up equity capital of the company and not to the total debts of the company. In the meeting of the creditors of the company to be held under Section 391 of the Act, the value of creditors vote for ascertaining requisite majority of 3/4th in value has a reference to the total debt of the company and not to the total paid up capital. A preference share is not a debt instrument. Preference share amount is a capital and not a debt. Thus, in the meeting of the creditors, it would not be possible to assign a value to the vote of a holder of preference share. If we were to hold that the preference shareholders who are not paid dividend for more than two years are also entitled to attend the meeting of the creditors under Section 391 of the Act and to vote thereat, then it would be impossible to determine what would be the value to their votes vis-a-vis the value of votes of creditors. It would be wrong to contend that preference shareholders have a right to vote but, valuation of their vote is unascertainable. We are therefore of the view that preference shareholders are not entitled to attend and vote at the meeting of the creditors convened under Section 391 of the Act even though dividend on the preference shares have remained unpaid for more than 2 years.

(emphasis supplied)

10. The Division Bench of Calcutta High Court in *Hindustan Gas and Industries Ltd.*(supra) has also held that a debenture-holder, as a creditor, has a right to sue the company, whereas a shareholder has no such right and preference shareholder is a shareholder of the company. Paragraphs 10, 11, 12 and 13 of the said judgement read as under :-

10 Mr. Sengupta also submitted that the holder of a redeemable preference share did not stand on the same footing

as a creditor and could not sue the company for redemption of the shares as an ordinary creditor. In support of his contentions Mr. Sengupta cited the following passages from the "Company Law" by Robert R. Pennington, 2nd edn. at pages 127-128 and at page 164:

"A shareholder is not a creditor of the company for his share capital, although he undoubtedly has a contractual right to share in the company's assets in a winding up after its creditors have been paid, and if the company has traded successfully, his share may amount to very much more than the money he originally subscribed. The reason why share capital is shown on the liabilities side of the company's balance sheet is that a balance sheet shows what payments would fall to be made out of the company's assets if it were wound up immediately, and one of these payments, is, of course, share capital. It does not follow that all such payments are debts of the company ; share capital is one of the payments which is not.

11 Share capital, then, is the amount contributed by the shareholders to the company's resources. The money with which the contribution is made becomes the company's property forthwith, but the company does not become the shareholder's debtor for its repayment. The shareholder has a number of contractual and statutory rights against the company, among which are a right to share in its assets when it is wound up, and a right to receive dividends out of its profits when duly declared in accordance with the articles and it is primarily these two rights which give his shares a value, and make them saleable." (Pages 127-128).

"Unlike 'capital' or 'share capital', the expression 'loan capital' is not a legal term of art, but a commercial expression used to indicate the total amount borrowed by a company otherwise than by short and medium term borrowing. Loan capital will be represented by mortgages, debentures and loan stock, and the law relating to these securities, which is vastly different from that relating to share capital, will be dealt with in Chapter 12. Loan capital appears on the liabilities side of the company's balance sheet beneath share

capital and reserves, but unlike share capital, it does represent indebtedness by the company, and holders of loan capital have the remedies of creditors to recover what the company owes them." (Page 164.)

12 Consequently, when the date for the redemption of redeemable preference shares has passed, their holders cannot sue the company for the repayment of their capital as creditors though they may petition for the winding up of the company as shareholders."

13 On a consideration of the provisions of the Companies Act, 1956, as also similar provisions in the English company law we cannot persuade ourselves to accept the contentions of the assessee and hold that when a company issues redeemable preference shares it is in fact obtaining a loan as it could by issuing debentures. There is a fundamental difference between the capital made available to a company by issue of a share and money obtained by a company under a loan or a debenture. Respective incidences and consequences of issuing a share and borrowing money on loan or on a debenture are different and distinctive. A debenture-holder as a creditor has a right to sue the company, whereas a shareholder has no such right. Apart from that the scheme of the Companies Act and in particular the forms and contents of its balance-sheets are extremely rigid and, in our view, by reason of the specific compartments in such accounts it is not possible to convert an item of capital into an item of loan as has been suggested on behalf of the assessee."

(emphasis supplied)

11. The Division Bench of Delhi High Court in *National Co-operative Development Corporation* (supra), while considering appeal filed under Section 260(A) of the Income Tax of Delhi, 1981, approved finding of the Gujarat High Court. If a company defaults in redeeming the preference shares by the date fixed for redemption, the holder thereof cannot compel

it to do so by suing in debt for the return of his capital or by filing for a mandatory injunction. Paragraph 10 reads as under :-

“10 We may also refer to a judgment of the Gujarat High Court in Anarkali Sarabhai v. CIT Gujarat [1982] 138 ITR 437. That case arose under the Income Tax Act and the question was whether the assessee was liable to pay capital gains tax on receipt of an amount equal to the face value of the preference shares when the company redeem them. The assessee received from the company an amount which exceeded the amount which he had paid for these shares. In deciding this question the Gujarat High Court had to examine the nature of redeemable preference shares issued by a company. The Court referred to Palmer's Company Law (page 356, paragraph 1, 22nd Edition) wherein it was observed that "from the financial point of view, redeemable preference shares are a hybrid form of shares and debentures, incorporating features of both, and ITA Nos.512/2011, 513/2011, 810/2011, being closer to the latter than other preference shares, but from the legal point of view they are shares and are treated as such". The Court further noted the view of the learned author in Pennington's Company Law, 4th Edition, page 195 that if redemption of the petitioner's shares would make a company insolvent, it may not be allowed to redeem those shares because repayment of preference capital would be a fraud upon the company's creditors. According to the Gujarat High Court this view of the author clearly indicated that the holder of preference shares is not in the same position as that of a creditor. The learned author had also expressed the view in the aforesaid treatise, as noticed by the Gujarat High Court, that if a company defaults in redeeming the preference shares by the date fixed for redemption, the holder thereof cannot compel it to do so by suing in debt for the return of his capital or by filing for a mandatory injunction. This view of the author, according to the Gujarat High Court also negatives the contention that once the company decides to redeem its preference shares, the holder thereof would be in the position of a creditor.”

(emphasis supplied)

12. So far as the judgment in *Anarkali Sarabhai* (supra) relied upon by

Shri Arsiwala, in my view, the judgment actually aids petitioner. The Apex Court has noted that under Section 80 of the Companies Act, 1956, preference shares must not be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. When a preference share is redeemed by a company, what a shareholder does in effect is to sell the share to the company. Such a transaction is nothing but sale of the preference shares by the shareholders to the company. The Apex Court also held that if redemption of preference shares did not amount to sale, it would not have been necessary to specifically provide that the restriction imposed upon a company in respect of buying its own shares will not apply to redemption of shares issued under Section 80.

13. Petitioner has approached this Court on the basis that the company is not doing any business and the net-worth of the company is going down year after year. Petitioner has approached this Court as creditor of the company as could be seen from paragraph 31 of the petition where it says '*.....The Petitioner states that the present Petition seeking winding up of the Respondent Company is being filed by it in the capacity of a creditor and not as a shareholder...*'. As already held that petitioner cannot be a creditor and it is rather clear that redemption cannot be made except out of profits

of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption, in my view, the petition is not maintainable.

14. Petition stands dismissed. No order as to costs.

(K.R. SHRIRAM, J.)