Miheer H. Mafatlal Vs. Mafatlal Industries Ltd[1]: A Case Study

- *Chhavi Agarwal**

The Court sanctioned a Scheme of Amalgamation of two Public Limited companies, namely Mafatlal Industries Limited ('MIL') being the transferee-company with which Mafatlal Fine Spinning and Manufacturing Company Limited ('MFL' for short) being the transferor-company was to be amalgamated. In order to appreciate the grievance of the appellant it will be necessary to glance through a few relevant background facts.

PART I: FACTS OF THE SITUATION:

The respondent-company MIL was incorporated in 1913 under the name 'The New Shorrock Spinning & Manufacturing Co. Limited' and its name was subsequently changed to 'Mafatlal Industries Limited' as per the fresh Certificate of Incorporation in Jan'74 as sanctioned by the Registrar of Companies. The objects of the transferee-company MIL as per its Memorandum of Association, inter alia, included activity of carrying on all or any of the businesses such as cotton spinners and doublers, wool, silk, flax, jute and hemp etc. The Authorised Share Capital of the respondent-company was Rs. 100,00,00,000 divided into 30,05,500 equity shares of Rs. 100 each and 69,94,500 unclassified shares of Rs. 100 each. The subscribed Share Capital of the respondent-company as on 31st March 1993 was Rs. 26.30 divided into 26,90,000 equity shares of Rs. 100 each.

The MFL being transferor-company was incorporated on 20th April 1931 under the Baroda State Companies Act and had been carrying on the business of manufacture and sale of textile piece goods and chemicals. Its registered office was situated at Bombay. It was engaged in the manufacture and sale of textiles and fluorine based chemicals. The Authorised Share Capital of the transferor-company was Rs. 30 crores divided into 30,00,000 ordinary shares of Rs. 100 each. The Subscribed Share Capital of the transferor-company as on Mar'93 was Rs. 26,25,77,100 divided into 26,25,771 ordinary shares of Rs. 100 each. Subsequent to 31st March 1993 the transferor-company had allotted 382 ordinary shares of Rs. 100 each. The transferor-company had also issued and allotted further 1,00,000 ordinary shares of Rs. 100 each at a premium of Rs. 200 per share on conversion of 1,00,000 Partly Convertible Debentures of the face value of Rs. 2,000 each issued to Financial Institutions with effect from 1st February 1994 by the transferor-company

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[1] JT 1996 (8) 205

The transferor-company MFL is proposed to be amalgamated with the respondent-company MIL. Hitherto, with limited resources and capacity, either company had to forego business opportunities which would otherwise have been profitable to the group etc. The director of the respondent-company MIL and transferor-company MFL approved the proposal for amalgamation of the MFL with MIL and pursuant to the respective Resolutions passed by them the detailed Scheme of Amalgamation was finalised. The directors of both the companies of the opinion that such amalgamation was in the interest do both the companies

The appellant who has objected to the amalgamation is himself one of the directors of the transferor-company being MFL. So far as the transferor-company MFL is concerned as its registered office is located at Bombay the corresponding application on behalf of the transferor-company for sanctioning this very Scheme of Amalgamation was moved in the Bombay High Court. The appellant at this stage did not object to this very Scheme for amalgamation. The Bombay High Court sanctioned the said Scheme. As the registered office of the transferee-company is located at Ahmedabad the respondent transferee-company had approached the High Court of Gujarat for sanctioning this very Scheme of Amalgamation on behalf of the transferee-company. It is at this stage that the appellant who was one of the shareholders of the transferee-company filed his objection to the Scheme of Amalgamation moved under Section 391of the Act

Earlier the learned Single Judge directed convening of meeting of equity shareholders of the respondent-company where overwhelming majority of the equity shareholders approved the Scheme. At the said meeting, resolution was passed without modification by the requisite majority as 5298 members holding 19, 36, 964 fully paid equity shares voted in favour of the Scheme and 143 members holding 86, 061 fully paid equity shares voted against the Scheme. Thereafter the respondent-company MIL filed Company Petition No. 22 of 1994 under Section 391(2) of the Act. In response to the notice issued to the Central Government under Section 394A of the Act the learned Additional Central Government Standing Counsel appeared before the High Court and submitted to the orders of the Court making it clear that the Central Government is not to make any representation in favour or against the proposed Scheme

Nine objections were raised by the appellant. Prolonged hearing the learned Single Judge S.D. Shah, J., over-ruled these objections. The Division Bench of the High Court to which the appellant carried the matter in appeal confirmed the aforesaid decision of the learned Single Judge. Hence, this appeal

Court in proceedings:

The aforesaid provisions of the Act[2] show that compromise or arrangement can be proposed between a company and its creditors or any class of them or between a company and its members or any class of them. Such a compromise would also take in its sweep any scheme of amalgamation/merger of one company with another. When such a scheme is put forward by a company for the sanction of the Court in the first instance the Court has to direct holding of meetings of creditors or class of creditors or members or class of members who are concerned with such a scheme and once the majority in number representing three-fourths in value of creditors or class of creditors or members or class of members, as the case may be, present or voting either in person or by proxy at such a meeting accord their approval to any compromise or arrangement thus put to vote, and once such compromise is sanctioned by the Court, it would be binding to all creditors or class of creditors or members or class of members, as the case may be, which would also necessarily mean that even to dissenting creditors or class of creditors or dissenting members or class of members such sanctioned scheme would remain binding. Before sanctioning such a scheme even though approved by a majority of the concerned creditors or members the Court has to be satisfied that the company or any other person moving such an application for sanction under Sub-section (2) of Section 391 has disclosed all the relevant matters mentioned in the proviso to Sub-section (2) of that Section. So far as the meetings of the creditors or members, or their respective classes for whom the Scheme is proposed are concerned, it is enjoined by Section 391(1)(a) that the requisite information as contemplated by the said provision is also required to be placed for consideration of the concerned voters so that the parties concerned before whom the scheme is placed for voting can take an informed and objective decision whether to vote for the scheme or against it. On a conjoint reading of the relevant provisions of Sections 391 and 393 it becomes at once clear that the Company Court which is called upon to sanction such a scheme has not merely to by go by the ipse dixit of the majority of the shareholders or creditors or their respective classes who might have voted in favour of the scheme by requisite majority but the pros and cons of the scheme with a view to finding out whether the scheme is fair, just and reasonable and is not contrary to any provisions of law and it does not violate any public policy. It is trite to say that once the scheme gets sanctioned by the Court it would bind even the dissenting minority shareholders or creditors. It can be postulated that even in case of such a Scheme of Compromise and Arrangement put up for sanction of a Company Court it will have to be seen whether the proposed scheme is lawful and just and fair to the whole class of creditors or members including the dissenting minority to

[2] 391 and 393 of the Act.

whom it is offered for approval and which has been approved by such class of persons with required majority vote. The question which arose was:

Whether the Court has jurisdiction like an appellate authority to minutely scrutinise the scheme and to arrive at an independent conclusion whether the scheme should be permitted to go through or not when the majority of the creditors or members or their respective classes have approved the scheme as required by Section 391 Sub-section (2)?

It is the commercial wisdom of the parties to the scheme who have taken and informed decision about the usefulness and propriety of the scheme by supporting it by the requisite majority vote that has to be kept in view by the Court. The Court certainly would not act as a court of appeal and sit in judgment over the informed view of the concerned parties to the compromise as the same would be in the realm of corporate and commercial wisdom of the concerned parties. The supervisory jurisdiction of the Company Court can also be culled out from the provisions of Section 392 of the Act. Of course this Section deals with post-sanction supervision. It is obvious that the supervisor cannot ever be treated as the author or a policy maker.[3]

Section 394 casts an obligation on the court to be satisfied that the scheme for amalgamation or merger was not contrary to public interest. The basic principle of such satisfaction is that it should not be unfair or contrary to public policy or unconscionable. In amalgamation of companies, the courts have evolved, the principle "prudent business management test" or that the scheme should not be a device to evade law. But when the court is concerned with a scheme of merger with a subsidiary of a foreign company then test is not only whether the scheme shall result in maximizing profits of the shareholders or whether the interest of employees was protected but it has to ensure that merger shall not result in impeding promotion of industry or shall obstruct growth of national economy.[4]

PART II: ISSUES RAISED

In view of the aforesaid settled legal position, therefore, the scope and ambit of the jurisdiction of the Company Court has clearly got earmarked. The following broad contours of such jurisdiction have emerged:

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[3] *In Re. Alabama, New Orleans Texas and Pacific junction Railway Company* reported in 1891 (1) C D 213, - *Continental Supply Co. Ltd., Re*. (1992) 2 Ch. 723, *Re. Mankam Investments Ltd. and Ors.* (1995) 4 Comp LJ; *Hindustan Lever Employee's Union v. Hindustan Lever Ltd. and Ors.* MANU/SC/0101/1995

[4] *Reliance on English decisions Home & Co. Ltd., Re* 1933 All ER Rep 105, Ch D; *Bugle Press Ltd. Re.* 1961 ch

1. The sanctioning court has to see to it that all the requisite statutory procedure for supporting such a scheme has been complied with and that the requisite meetings as contemplated by Section 391(1)(a) have been held.

2. That the scheme put up for sanction of the Court is backed up by the requisite majority vote as required by Section 391 Sub-Section (2).

3. That the concerned meetings of the creditors or members or any class of them had the relevant material to enable the voters to arrive at an informed decision for approving the scheme in question. That the majority decision of the concerned class of voters is just and fair to the class as a whole so as to legitimately bind even the dissenting members of that class.

4. That all necessary material indicated by Section 393(1)(a) is placed before the voters at the concerned meetings as contemplated by Section 391 Sub-section (1).

5. That all the requisite material contemplated by the proviso of Sub-section (2) of Section 391 of the Act is placed before the Court by the concerned applicant seeking sanction for such a scheme and the Court gets satisfied about the same.

POINT NO: 1: It was vehemently contended that the explanatory statement placed for consideration of the meeting of equity shareholders was not a complete statement and relevant material indicating the interest of the director of MIL Shri Arvind Mafatlal was not placed before the voters with the result that the majority vote supporting the scheme got vitiated.[5] The special grievance of the appellant is to the effect that the director Shri Arvind Mafatlal and his group were at the helm of affairs of the transferee-company. In this connection submitted that under Section 393(1)(a) of the Act the company is enjoined to mention any material interest and the effect of the compromise on such special interest, which did not happen. Now a mere look at Section 393(1)(a) shows that the special interest must satisfy the following requirements

[5] It is proposed to amalgamate MF with MIL so as to enable the carrying on of the combined business more economically and advantageously. Amalgamation of both the companies would lead to substantial benefits in view of synergy of operations. The amalgamation of both the companies would give improved capital structure which would lend better flexibility in capital gearing which would enable the amalgamated company to raise required finance at better terms. A larger company would generate more confidence in the investors and with the persons dealing with the company and will afford access to resources easily and at lower costs. The amalgamation of M.F. with MIL will pave the way for better, more efficient and economic control in the running operations and would lead to economy in the administrative and management cost, resulting in improving profitability. The amalgamated company will have a strong and large resource funds. The combined Technological Managerial and financial resources would enhance the capability of the amalgamated company to invest in larger and sophisticated projects to ensure rapid growth. The amalgamated company's Textiles Division with five operative units at its disposal will have flexibility in its operation

before it can be treated to be a relevant special interest: **1.** The director's interest must be a special interest different from the interest of other members who are the voters at the meeting. **2.** The compromise which is put to vote must have an effect on such special interest of the director. **3.** Such effect must be different from the effect of compromise on similar interest of other persons who are called upon to vote at the meeting. The appellant stated that there was a pending litigation between the appellant and Shri Arvind Mafatlal in Bombay High Court. That Shri Arvind Mafatlal had sought a declaration in a pending suit against the appellant that the latter was required to sell off his share-holding in the transferee-company MIL to the plaintiff Arvind Mafatlal who was director of MIL. In this very suit the appellant had filed a counter-claim to for requiring transferring AM share-holding in the transferee-company in favour of the appellant as per the Family Arrangement of 1979. The court failed to appreciate how the personal family dispute can have any linkage or nexus with the Scheme of Amalgamation of these two companies which was put to vote before the equity shareholders. That such non-disclosure of interest had no impact on the voting pattern. From the pattern of voting it became apparent that out of 100% of the share capital 75.75 per cent in value participated of which 95.75 per cent voted in favour of the proposed Scheme. Out of 95.75 per cent of the votes in value, a paltry 8.43 per cent votes had been attributed to Arvind Mafatlal group consisting of individuals and trust. 39.45 per cent were the votes attributable to financial institutions which can be said to have no interest other than their own interests as men of business in considering the proposed Scheme. Over 23 per cent votes have been attributed to public limited companies or private limited companies which held the shares of MIL and in which Arvind Mafatlal was also alleged to have interests. Thus non-mentioning of the private dispute had in fact no impact. Moreover, the appellant had not thought it fit to remain present in the meeting of equity shareholders and on the contrary he got himself represented through proxy who had no night to speak. It may also be kept in view that the explanatory statement no way emphasised that it is the management of the transferee-company by Shri Arvind Mafatlal which is going to be better monitored and managed by him after the merger in question. Consequently the interest of Arvind Mafatlal in the share-holding or likely future impact thereon by the litigation was de hors the Scheme. The first point for determination is, therefore, answered in the negative

POINT NO 2: The fact that what was required to be considered while sanctioning the scheme was bona fides of the majority acting as a class and not of single person.[6] It is not possible to agree that the majority had acted unfairly to the appellant and had not protected his interest when what was to be protected was the class interest of minority

[6] *Hellenic and General Trust Limited* reported in (1976) 1 WLR 123

shareholders falling in the same class along with the majority. It is not the contention of the appellant that while voting by majority in favour of the Scheme the majority had acted with any oblique motive to fructify any adverse commercial interest. It is also to be kept in view that the Board of Directors of the respective companies had approved the Scheme. The appellant was himself one of the directors of the transferor-company who had no objection. So far as the transferee-company is concerned though appellant was not a director he was 5% shareholder who did not think it fit to personally remain present at the time of voting and simply relied upon proxy. It is, therefore, too late in the day for him to contend that the Scheme was unfair to him. Not only that but even when that Scheme was put for sanction before the Bombay High Court on behalf of the transferor-company the appellant did not object meaning thereby appellant had no objection to the transferor-company losing its identity and getting merged in the transferee-company pursuant to the proposed Scheme. The second point for determination, therefore, also is found to be factually not sustainable.

The evidence on record shows that the shareholding of ANM Group can be worked out to 30.42% approximately. As against aforesaid share-holding the share-holding of financial institutions and MHM group in MIL would work out to 39.03% and that of appellant's group works out at 29.05% while that of other shareholders would work out to 34.34%. Hence it cannot be said that Arvind Mafatlal is at the helm of affairs of the respondent-company. It is also pertinent to note that financial institutions and statutory corporations held substantive percentage of shares in respondent-company. This class of shareholders who are naturally well informed about the business requirements and economic needs and the requirements of corporate finance in the light of their personal interest would not have wholly approved the Scheme if it was contrary to the interest of shareholders as a class. Point No. 2 is accordingly answered in the negative

POINT NO 3: In a way the answer to point No. 2 necessarily results in negativing this point also. Even that apart we fail to appreciate how the Scheme of Amalgamation can be said to be unfair and amounting to suppression of minority shareholders represented by the appellant. The transferee-company because of the amalgamation will then be having more diversified activities and if at all according to the appellant, because of this future success, if any, in the counter-claim he is going to replace Arvind Mafatlal and his group in the management of the respondent-company he would have larger field to operate and larger company to manage. We fair to appreciate as to how such a scheme from any point of view can amount to suppression of appellant's minority interest in the share-holding of the company. It has to be kept in view that the question of bona fide of the majority shareholders or the alleged suppression by them of the minority shareholders or their attempt to suffocate their interest has to be judged from the point

of view of the class as a whole. Question is whether the majority equity shareholders while acting on behalf of the class as a whole had exhibited any adverse interest against the appellant's minority shareholders also having similar interest as members of the same class, while approving the Scheme or had acted with any oblique motive to whittle down such a class interest of the minority. As we have seen earlier no such situation ever existed.

POINT NO 4: The present controversy centres round a meeting of members. Section 82 provides that 'the shares or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company'. As per Section86 the share capital of a company limited by shares formed after the commencements of this Act, or issued after such commencement, shall be of two kinds only, namely, equity share capital and preference share capital. So far as the Articles of Association of respondent-company are concerned they also contemplate two classes of shareholders, namely, equity and preference shareholders. No separate class of equity shareholders is contemplated either by the Act or by the Articles of Association of respondent-company. Appellant is admittedly an equity shareholder. Therefore, he would fall within the same class of equity shareholders whose meeting was convened by the orders of the Company Court. However it is vehemently contended by learned Counsel for the appellant that because of the family arrangement of 1979 on which he relies he was a special class of minority equity shareholder who had separate rights against the director of the company, therefore, a separate meeting had to be convened as he represented a class within the class of equity shareholders. It is difficult to agree with this contention. On the express language of Section 393(1) it becomes clear that where a compromise or arrangement is proposed between a company and its members or any class of them a meeting of such members or class of them has to be convened. This clearly presupposes that if the Scheme of Arrangement or Compromise is offered to the members as a class and no separate Scheme is offered to any subclass of members which has a separate interest and a separate Scheme to consider, no question of holding a separate meeting of such a Sub-class would at all survive. Even otherwise it becomes obvious that as minority shareholder if the appellant had to dissent from the Scheme his dissent representing 5% equity shareholding would have been visible both in a separate meeting if any, of his Sub-class or in the composite meeting where also his 5% dissent would get registered by appellant either remaining present in person or through proxy. The Court does not itself consider at this point what classes of creditors or members should be made parties to the scheme. This is for the Company to decide, in accordance with what the scheme purports to achieve.

If there are different groups within a class the interests of which are different from the rest of the class, or which are to be treated differently under the Scheme, such groups must be treated as separate class for the purpose of the scheme. Moreover, when the Company has decided what classes are necessary parties to the scheme, it may happen that one class will consist of a small number of persons who will all be willing to be bound by the scheme. In that case it is not the practice to hold a meeting of that class, but to make the class a party to the scheme and to obtain the consent of all its members to be bound. It is however, necessary for at least one class meeting to be held in order to give the Court jurisdiction under the Section. The fourth point for determination, therefore, is answered in the negative

POINT NO. 5: So far as this contention is concerned it has to be kept in view-that before formulating the proposed Scheme of Compromise and Amalgamation an expert opinion was obtained by the respondent-company as well as the transferor-company. M/S. C.C. Chokshi & Co., a reputed firm of Chartered Accountants, having considered all the relevant aspects suggested the aforesaid exchange ratio keeping in view the valuation of shares of respective companies. It must at once be stated that valuation of shares is a technical problem. Pennington in his 'Principles for Company Law' mentions four factors which had to be kept in mind in the valuation on shares :(1) Capital Cover, (2) Yield, (3) Earning Capacity, and (4) Marketability. For arriving at the fair value of share, three well known methods are applied : (1) The manageable profit basis method (the Earning Per Share Method) (2) The net worth method or the break value method, and (3) The market value method.

Appellant himself as a director of that transferor-company gave green single to the Scheme. It was though submitted that form the point of view of the transferor-company it was very profitable to have two shares of transferee-company against five shares of transferor-company. But the difficulty arises only from the point of view of transferee-company shareholders. According to them the proper exchange ratio would be one share of transferee-company to six shares of transferor-company. It is difficult to appreciate this contention of the appellant. It has to be kept in view that appellant never bothered to personally remain present in the meeting. He sent his proxy only to record his dissent vote which was in microscopic minority of 5% as compared to 95% majority vote.

Not only that even before the Court he did not submitted and contrary expert opinion for supporting his ipse dixit that the correct ratio would be 6 : 1. It is not for the Court to sit in appeal over this value judgment of equity shareholders who are supposed to be men of reasonability. With open eyes they have okayed this ratio and the entire Scheme. It is a laid principle that where statutory majority had accepted the offer the onus must rest

on the applicants to satisfy the court that the price offered is unfair.[7] In the present case not only expert like M/s. C.C. Chokshi & Co. had suggested the ratio but another independent body ICICI Security & Finance Company Limited reached the same conclusion. Mere look at both the report show that various factors underlying the Scheme were taken into consideration. The fifth point for determination is also, therefore, answered in the negative.

Conclusion: This case helped in clarifying situation related to amalgamations. The court clarified as to the specific situation and compliance the court has to look into before it sanctions the scheme, like majority etc. It was laid down that things only which has a nexus with the scheme and can effectively vitiate the voting needs to be disclosed. The voters should be having all the relevant material for making an informed decision for approving a scheme. That the majority decision of the concerned class of voters is just and fair to the class as a whole so as to legitimately bind even the dissenting members of that class.

[7] Maughm, J., *In Re Hoare & Co.* (No. 2) case (1933) All ER 105 ; *Re Kamala Sugar Mills Limited* 55 Company Cases p. 308MANU/TN/0005/1980