NATIONAL COMPANY LAW APPELLATE TRIBUNAL, NEW DELHI

Company Appeal (AT) No.387 of 2017

(Arising out of order dated 05.10.2017 passed by the National Company Law Tribunal, Hyderabad Bench, Hyderabad in CP No.35/59/HDB/2017.

In the matter of:	**Before NCLT**	**Before NCLAT**
1. M/s Relisys Medical Devices Ltd S.Y. No.312, Pocharam Road, Mangalapally, Village, Ibrahimpatnam -501510 Andhra Pradesh	**Applicant**	**Appellant**
Versus		
1. D. Raju Reddy, 45711, Vineyard Ave, Fremont, CA 94536, United State of America	**Respondent**	**1st Respondent**
2. The Registrar of Companies, Hyderabad. 2nd Floor, Corporate Bhawan, GSI Post, Tattiannaram Nagole, Bandlaguda, Hyderabad-500068	**--**	**2nd Respondent**

Present: For Appellant:- Mr. Y. Suryanarayan, Mr. Naveen Dahiya, Ms. Manisha Chaudhary and Shri Mansuymer Singh, Advocates for the appellants.

For Respondents: - Mr.Sanjib K. Mohanty, Advocate (amicus curiae).

JUDGEMENT

BALVINDER SINGH, MEMBER (TECHNICAL)

1. The present appeal has been preferred by the appellant against the order passed in C.P. No.35/59/HDB/2017 by the National Company Law Tribunal, Hyderabad Bench, Hyderabad (hereinafter referred to as

the "Tribunal") dated 5th October, 2017 under Section 59 of the Companies Act, 2013.

2. The brief facts of the case are that the Appellant company was incorporated as Private Limited Company on 13th October, 1997 under the provisions of Companies Act,1956. The main object of the appellant company is to establish, engage, in carry on and run or to carry on business as provided in India or elsewhere diagnostic centres, hospitals, nursing homes, convalescent homes, blood banks, medicinal and allied training research centres, laboratories, mobile diagnostics centres and dispensaries, run libraries hold health centres and such other facilities that may be required for the purpose of providing medical services of all kinds and also to provide relief to the poor and needy by free/concessional services. 1st respondent, non-resident individual, was the shareholder of the appellant company. The appellant company had issued 1,92,441 Compulsory Convertible Debentures (CCDs) of Rs.10 each at a premium of Rs.60 each to 1st respondent on 1.12.2011. At the time of issue of CCDs the fair market value of the shares of the appellant company was Rs.64.22. Thereafter on 6.8.2013, the appellant company converted 1,92,441 CCDs into 4,29,419 equity shares of Rs.10/- each at a premium of Rs.21.37 each and allotted the shares to 1st respondent, lower than fair value of equity shares (Rs.64.22) determined upfront. The fair value of shares of the company as on 6th June, 2013 was Rs.31.37. As the company had contravened the provisions of FEMA, 1999 while issuing said shares, the company submitted a compounding application vide its letter dated 9th

September, 2016 for contravening para 9(1)B of Schedule 1 to Notification No.FEMA 20/2000-RB dated 3rd May, 2000. In pursuance to the said letter of appellant the Reserve Bank of India vide their letter dated 1st March, 2017 advised the appellant as under;

I) Unwind the excess shares allotted; or

II) Bring in additional funds equivalent to the shares allotted and thereafter apply for compounding for the contraventions stated.

3. On receipt of letter from the Reserve Bank of India the company sought no objection from 1st respondent for rectification of register in the form of cancellation of 219658 equity shares of Rs.10 each excess allotted to him. The appellant company, therefore, filed company petition under Section 59 of the Companies Act, 2013 thereby contending that the violation in question has taken place due to the circumstances beyond the control of the company and there is no malafide intention on their part and approaching the Tribunal voluntarily.

4. After hearing the parties, the Tribunal passed the order dated 5th October, 2017, relevant portion of which is as under:-

"14. While the case is pending adjudication before the Tribunal, the Registrar of Companies at Hyderabad for the State of Andhra Pradesh and Telangana, is directed to furnish his comments o the subject issue vide letter No.NCLT-Hyd/CP/35/59/HDB/2017/2301 dated 25.7.2017. Accordingly, the ROC has filed his report vide Reference No.ROCH/Legal/Sec59/28153/Relisys/Stack/2017 dated 25.7.2017 by inter alia stating that the petitioner company has

allotted 429419 equity shares on 6.8.2013 and subsequently filed its Balance Sheet for the years 2014-2016, which reflects the paid up capital including the allotment of shares in question. Therefore, he submitted that rectification of register of members by cancelling the excess allotment of shares leads to reduction of paid up capital. And there is a prescribed procedure for reduction of share capital in Memorandum of association and Articles of Association of the company and the Companies Act, 2013.

15. The above facts clearly shows that the petitioner company has failed to follow its Memorandum and Articles of Association of the Company, the relevant provisions of Companies Act, 2013 and FEMA Regulations, 2000 so as to make good violations of FEMA Regulations as mentioned supra. Therefore, the present petition filed under Section 59 of the Companies Act is not maintainable and it is reliable (*should be liable)* ***to be rejected for the grounds mentioned supra. In fact, the concerned authorities have to initiate appropriate action by this time against the Company, for violation of FERA regulations.***

16. In view of the above facts and circumstances of the case, the company petition bearing No.CP/35/59/HDB/2017 is hereby dismissed. However, the dismissal of this petition, will not come in the way of filing fresh appropriate petition by the company, duly following extant provisions of law. No order as to costs."

5. Being aggrieved by the said order the appellant has filed the present petition and sought the following relief:

   i) Decide the substantial question of law as set out above.

   ii) Allow the appeal by quashing and setting aside the order of the National Company Law Tribunal Hyderabad Bench dated 5.10.2017 passed under Section 59 of the Companies Act, 2013 read with Rule 70 of the National Company Law Tribunal Rules, 2016 in CP No.35/59/HDB/2017.

   iii) Pass such other order or orders as the Hon'ble Tribunal may deem fit and proper in the interest of justice.

6. During the preliminary hearing, notice was issued to the 1st Respondent and 2nd respondent was also made a party to the appeal. Despite notice 1st respondent did not appear and it is apprised to the Appellate Tribunal that the 1st respondent had also not appeared before the Tribunal. However, no objection to rectification of the Register of Members was brought on record on behalf of 1st respondent.

7. The appellant has argued that the Tribunal is not justified in dismissing the application by contending that a Company cannot be the applicant seeking rectification of its register of members.

8. The appellant further argued that the Tribunal has committed a serious error by assuming that the company has not followed the procedure prescribed under its Articles and memorandum of Association, Companies Act and FEMA for increasing its authorised capital when there is no shred of any document to suggest ath the company has not followed the procedure so prescribed.

9. The appellant admitted that the only violation committed by the appellant under FEMA was to allot shares at Rs.31.37 instead of Rs.64.22 and that there was no other violation under FEMA and it is as a result of such under valuation of shares that excess shares of 219658 were allotted to 1st respondent.

10. The appellant stated that the rectification of register of members by cancelling the excess shares allotted is merely an accounting entry whereby the amount paid up on the excess shares sought to be cancelled is credited to the securities premium account and there is no return of capital and does not tantamount to reduction of capital as contemplated under Section 66 of the Companies Act.

11. 2nd respondent forwarded its report vide letter dated 9.3.3018 stating therein the facts of the case what has been stated submitted in para 2 above. 2nd appellant however submitted that in accordance with FEMA Regulations, the price/conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments and the price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments.

12. During the course of arguments, the appellant company filed an affidavit-cum-undertaking and submitted that if this Tribunal permits, the appellant would take the necessary steps legally required for cancelling the excess shares allotted and comply with other legal formalities as well as whatever directions this Tribunal gives. Learned

Amicus Curiae for ROC is not objecting to appellant wanting to follow procedure.

13. We have heard the learned counsel for the parties and perused the entire record.

14. The Tribunal vide impugned order in para 14 has observed as under:

> ***"And there is a prescribed procedure for reduction of share capital in Memorandum of association and Articles of Association of the company and the Companies Act, 2013."***

15. Reduction of share capital is defined in Section 100 of the Companies Act, 1956 (Section 66 of Companies Act, 2013), which is as under:-

> **"100. Special resolution for reduction of share capital-(1) Subject to confirmation by the Court, a company limited by shares or a company limited by guarantee and having a share capital, may, if so authorised by its articles, by especial resolution, reduce its share capital in any way; and in particular and without prejudice to the generality of the foregoing power, may-**
>
> **(a) extinguish or reduce the liability on any of its shares in respect of share capital not paid up;**
>
> **(b) either with or without extinguishing or reducing liability on any of its shares cancel any paid-up share capital which is lost, or unrepresented by available assets; or**
>
> **(c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company,**
>
> **And may, if an so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly."**

16. Application of premiums received on issue of shares is defined in Section 78 of Companies Act, 1956 (Section 52 of Companies Act, 2013) which is as under:-

> **52. Application of premiums received on issue of shares**
> **"(*1*) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company."**

17. This case deals where the CCDs have been converted into shares at a wrong share premium. The money has already been received by the company and the allocation of the same between paid up share capital and securities premium has to be done. It is noted that security premium account for all practical purposes is to be treated as if security premium account were the paid up share capital of the company as per Section 52 of the Companies Act, 1956. Securities premium amount has been determined wrongly short and consequently paid up capital have been allocated of more amount than required. Therefore, change in composition between the security premium account and paid up share capital will not amount to reduction in capital as both the components are treated as paid up capital. Further a reading of Section 100 of the Companies Act, 1956 shows that this case is not covered under any of sub-clauses (a), (b) and (c) of Clause (1).

18. The RBI vide letter No.HY.FE.FID/1755/14.04.542/2016-17 has advised the appellant as under:

A) Unwind the excess shares allotted; or

B) Bring in additional funds equivalent to the shares allotted;

and thereafter apply for compounding for the contraventions stated.

As the appellant has opted to unwind the excess shares allotted, therefore, this will make a case of rectification of wrongful calculation of share capital and securities premium and not reduction of share capital because the security premium account is also to be treated as paid up share capital. This is a case where security premium amount will be increased and equal amount of paid up capital will be decreased and there will be no change in the overall amount allocated to paid up share capital and security premium account.

19. In view of the above the following order is passed.

20. The appellant shall take steps and cancel the excess shares 219658 allotted to 1st respondent and the total amount received for issuing CCDs will be utilised for issuing 209761 shares of Rs.10/- each at a premium of Rs. 54.22 as on 6.8.2013. The amount of premium will be transferred to security premium account in the books of accounts. The balance sheets filed after 6.8.2013 will be refiled duly certified by a chartered accountant. For this process the company will comply with all other legal formalities as per law and Companies Act, 2013. This order will not come in the way of RBI for taking any action for contravention of FEMA Regulations against the appellant company.

21. In view of the above, the appeal is disposed of. Accordingly no order as to costs.

(Justice A.I.S. Cheema)
Member (Judicial)

(Mr. Balvinder Singh)
Member (Technical)

New Delhi

Dated: 23-05-2018

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