

M/s. Madhusudan Gordhandas & Co.

Vs

Madhu Woollen Industries Pvt. Ltd.

Civil Appeal No. 1113 of 1970

(A. N. Ray, D. G. Palekar JJ)

29.10.1971

JUDGMENT

RAY, J. –

1. This is an appeal by certificate from the judgment, dated April 3, 1970, of the High Court of Bombay confirming the order of the learned Single Judge refusing to wind up the respondent company.
2. The appellants are a partnership firm. The partner are the Katakias. They are three brothers. The appellants carry on partnership business in the name of Madhu Wool Spinning Mills.
3. The respondent company has the nominal capital of Rs. 10,00,000/- divided into 2,000 shares of Rs. 500/- each. The issued subscribed and fully paid up capital of the company is Rs. 5,51,000/- divided into 1,103 Equity shares of Rs. 500/- each. The three Katakia brothers had three shares in the company. The other 1,100 shares were owned by N. C. Shah and other members described as the group of Bombay Traders.
4. Prior to the incorporation of the company there was an agreement between the Bombay Traders and the appellants in the month of May, 1965. The Bombay Traders consisted of two groups known as the Nankishore and the Valia groups. The Bombay Traders was floating a new company for the purpose of running a Shoddy Wool Plant. The Bombay Traders agreed to pay about Rs. 6,00,000/- to the appellants for acquisition of machinery and installation charges thereof. The appellants had imported some machinery and were in the process of importing some more. The agreement provided that the erection expenses of the machinery would be treated as a loan to the new company. Another part of the agreement was that the machinery was to be erected in portions of a shed in the compound of Ravi Industries Private Limited. The company was to pay Rs. 3,100/- as the monthly rent of the portion of the shed occupied by them. The amount which the Bombay Traders would advance as loan to the company was agreed to be converted into Equity capital of the company. Similar option was given to the appellants to convert the amount spent by them for erection expenses into equity capital.
5. The company was incorporated in the month of July, 1965. The appellants alleged that the company adopted the agreement between the Bombay Traders and the appellants. The company however denied that the company adopted the agreement.
6. The appellants filed a petition for winding up in the month of January, 1970. The appellants alleged that the company was liable to be wound up under the provisions of Section 433(c) of the

Companies Act, 1956 as the company is unable to pay the following debts.

7. The appellants claimed that they were the creditors of the company for the following sums of money :

#A. (a) Expenses incurred by the appellants in connection with the erection of the plant and machinery . . Rs. 1,14,344.97 (b) Interest on the sum of Rs. 1,14,344.97 from April 1, 1966 till December 31, 1969, at 1% per mensem . . Rs. 51,453.13 (c) Commission on the sum of Rs. 1,14,344.97 due to the appellants at the rate of 1% per mensem from April 1, 1966 till December 31, 1969 . . Rs. 51,453.12B. (a) Compensation payable by the company to the appellants at the rate of Rs. 3,100/- per month for 22 months and 14 days in respect of occupation of the portion of the shed given by the appellants to the company on the basis of leave and licence . . Rs. 69,600.00 (b) Interest on the amount of compensation from time to time by the said company to the appellants till April 12, 1967 . . Rs. 7,857.00 (c) Further interest on compensation from April 13, 1967 to December 31, 1969 . . Rs. 21,576.00C. (a) Three Invoices in respect of 3 machines . . Rs. 85,250.00 (b) Interest on Rs. 85,250/- . . Rs. 37,596.00 (c) Commission at the rate of 1% on Rs. 85,250/- . . Rs. 37,596.00##

The appellants alleged that the company failed and neglected to show aforesaid indebtedness in the books of accounts save and except the sum of Rs. 72,556.01.

8. The other allegations of the appellants were these. The company incurred losses to March 31, 1969, for the sum of Rs. 6,21,177.53 and thereafter incurred further losses. The company stopped functioning since about the month of September, 1969. The company is indebted to Director and the firms of M/s. Nandkishore & Co. and M/s. Bhupendra & Co., in which some of the Directors of the company are interested. The indebtedness of the company to the creditors including the appellants' claim as shown by the company at the figure of Rs. 72,556.01 is for the sum of Rs. 9,56,829.47. The liability of the company including the share capital amounted to Rs. 14,98,923.33. The liability excluding the share capital of the company is Rs. 9,56,829.47 and the assets of the company on the valuation put by the company on the balance-sheet amount to Rs. 8,81,171.96. The value of the current and liquid assets is about Rs. 2,74,247.38. The appellants on these allegations alleged that even after the proposed sale of the machinery at Rs. 4,50,000/- the company would not be in a position to discharge the indebtedness of the company. The proposed sale of machinery for the sum of Rs. 4,50,000/- was at an under-value. The market-value was Rs. 6,00,000/-. The Board did not sanction such a sale.

9. It was alleged that the substratum of the company disappeared and there was no possibility of the company doing any business at profit. The company was insolvent and it was just and equitable to wind up the company.

10. When the petition was presented to the High Court of Bombay the learned Single Judge made a preliminary order accepting the petition and directing notice to the company. When the company appeared all the share-holders and a large number of creditors of the company of the aggregate value of Rs. 7,50,000/- supported the company and opposed winding up.

11. The company disputed the claims of the appellants under all the heads save the two amounts of Rs. 14,650/- and Rs. 36,000/-, being the amounts of the second and third invoices. The company

produced books of account showing a sum of Rs. 72,556.01 due to the appellants, as on March 31, 1969. The company alleged that the appellants had agreed to reduction of the debt to a sum of Rs. 14,850/- and to accept payment of the same out of proceeds of sale of the machinery.

12. The learned Single Judge held that the claims of the appellants were disputed save that a sum of Rs. 72,556.01 was payable by the company to the appellants and with regard to the sum of Rs. 72,556.01 the company alleged that there was a settlement at Rs. 14,850/- whereas the appellants denied that there was any such compromise. The learned Single Judge refused to wind up the company and asked the company to deposit the disputed amount of Rs. 72,556.01 in court. The further order was that if within six weeks the appellants did not file the suit in respect of the recovery of the amount of the company would be able to withdraw the amount and if the suit would be filed the amount would stand credited to the suit.

13. The High Court on appeal the judgment and order and found that the alleged claims of the appellants were very strongly and substantially denied and disputed.

14. The first claim for erection of plant and machinery was totally denied by the company. The defences were first that the books of the company showed no such transactions; secondly, there was no privity between the company and the persons in whose names the appellants made the claims; thirdly, the alleged claims were barred by limitation; and, fourthly, there was never any demand for the alleged claims either by those persons or by the appellants. The alleged claims for interest and commission were therefore equally baseless according to the defence of the company.

15. The second claim for compensation was denied on the grounds that the appellants were not entitled to any compensation for use of the portion of the shed and the alleged claim was barred by limitation. As to the claim for compensation the company relied on the resolution of the Board of Directors at which the Katakia Brothers were present as Directors. The Board resolved confirmation of the arrangement with M/s. Ravi Industries for use of the premises for the running of the industry at their shed at a monthly rent of Rs. 4,250/-. Prima facie the resolution repelled any claim for compensation or interest on compensation.

16. With regard to the claim of invoices the High Court held that the first invoice for Rs. 34,600/- was paid by the company to the appellants. The receipt for such payment was produced before the learned trial Judge. The appellants also admitted the same. As to the other two invoices for Rs. 14,650/- and for Rs. 36,000/- the amounts appeared in the company's books. According to the company the claim of the appellants was for Rs. 72,556.01 and the case of the company was that there was a settlement of the claim at Rs. 14,850.00.

17. The High Court correctly gave four principal reasons to reject the claims of the appellants to wind up the company as creditors. First, that the books of account of the company did not show the alleged claims of the appellants save except the sum of Rs. 72,556.01. Second, many of the alleged claims are barred by limitation. There is no allegation by the appellants to support acknowledgment of any claim to oust the plea of limitation. Thirdly, the Katakia Brothers who were the Directors resigned in the month of August, 1969 and their three shares were transferred in the month of December, 1969 and up to the month of December, 1969, there was not a single letter of demand to the company in respect of any claim. Fourthly, one of the Katakia Brothers was the Chairman of the Board of Directors and therefore the Katakias were in the knowledge as to the affairs of the company and the books of accounts they signed the balance-sheets which did not reflect any claim of the appellants except the two invoices for the amounts of Rs. 14,650/- and Rs. 36,000/-. The High

Court characterised the claim of the appellants as tainted by the vice of dishonesty.

18. The alleged debts of the appellants are disputed, denied, doubted and at least in one instance proved to be dishonest by the production of a receipt granted by the appellants. The books of the company do not show any of the claims excepting in respect of two invoices for Rs. 14,650/- and Rs. 36,000/-. It was said by the appellants that the books would not bind the appellants. The appellants did not give any statutory notice to raise any presumption of inability to pay debt. The appellants would therefore be required to prove their claim.

19. This Court in *Amalgamated Commercial Traders (P) Ltd. v. A. C. K. Krishnaswami and Another*, (35 Com Cas 456.) dealt with a petition to wind up the company on the ground that the company was indebted to the petitioner there for a sum of Rs. 1,750/- being the net dividend amount payable on 25 equity shares which sum the company failed and neglected to pay in spite of notice of demand. There were other share-holders supporting the winding up on identical grounds. The company alleged that there was no debt due and that the company was in a sound financial position. The resolution of the company declaring a dividend made the payment of the dividend contingent on the receipt of the commission from two sugar mills. The commission was not received till the month of May, 1960. The resolution was in the month of December, 1959. Under Section 207 of the Companies Act a company was required to pay a dividend which had been declared within three months from the date of the declaration. A company cannot declare a dividend payable beyond three months. This Court held that the non-payment of dividend was bona fide disputed by the company. It was not a dispute "to hide" its inability to pay the debts.

20. Two rules are well settled. First, if the debt is bona fide disputed and the defence is a substantial one, the court will not wind up the company. The court has dismissed a petition for winding up where the creditor claimed a sum for goods sold to the company and the company contended that no price had been agreed upon and the sum demanded by the creditor was unreasonable. See *London and Paris Banking Corporation*. ((1874) LR 19 Eq 44.) Again, a petition for winding up by a creditor who claimed payment of an agreed sum for work done for the company when the company contended that the work had not been properly done was not allowed. See *Re. Brighton Club and Horfold Hotel Co. Ltd.* ((1865) 35 Beav 204.)

21. Where the debt is undisputed the court will not act upon a defence that the company has the ability to pay the debt but the company chooses not to pay that particular debt, see *Re. A Company*. (94 SJ 369.) Where however there is no doubt that the company owes the creditor a debt entitling him to a winding up order but the exact amount of the debt is disputed the court will make a winding up order without requiring the creditor to quantify the debt precisely see *Re. Tweeds Garages Ltd.* (1962 Ch 406.) The principles which the court acts are first that the defence of the company is in good faith and one of substance, secondly, the defence is likely to succeed in point of law and thirdly the company adduces prima facie proof of the facts on which the defence depends.

22. Another rule which the court follows is that if there is opposition to the making of the winding up order by the creditors the court will consider their wishes and may decline to make the winding up order. Under Section 557 of the Companies Act, 1956 in all matters relating to the winding up of the company the court may ascertain the wishes of the creditors. The wishes of the shareholders are also considered though perhaps the court may attach greater weight to the views of the creditors. The law on this point is stated in *Palmer's Company Law*, 21st Edition, page 742 as follows : "This right to a winding up order is, however, qualified by another rule, viz., that the court will regard the wishes of the majority in value of the creditors, and if, for some good reasons, they object to a

winding up order, the court in its discretion may refuse the order." The wishes of the creditors will however be tested by the court on the grounds as to whether the case of the persons opposing the winding up is reasonable; secondly, whether there are matters which should be inquired into and investigated if a winding up order is made. It is also well settled that a winding up order will not be made on a creditor's petition if it would not benefit him or the company's creditors generally. The grounds furnished by the creditors opposing the winding up will have an important bearing on the reasonableness of the case, see *Re. P. and J. Wacrae Ltd.* ((1961) 1 AER 1 302.)

23. In the present case the claims of the appellants are disputed in fact and in law. The company has given prima facie evidence that the appellants are not entitled to any claim for erection work, because there was no transaction between the company and the appellants or those persons in whose names the appellants claimed the amounts. The company has raised the defence of lack of privity. The company has raised the defence of limitation. As to the appellants' claim for compensation for use of shed of the company denies any privity between the company and the appellants. The company has proved the resolution of the company that the company will pay rent to Ravi Industries for the use of the shed. As to the three claims of the appellants for invoices one is proved by the company to be utterly unmeritorious. The company produced a receipt granted by the appellants for the invoice amount. The falsehood of the appellants' claim has been exposed. The company however stated that the indebtedness is for the sum of Rs. 14,850/- and the company alleges the agreement between the company and the appellants that payment will be made out of the proceeds of sale. On these facts and on the principles of law to which reference has been made the High Court was correct in refusing the order for winding up.

24. Since the inception of the company Jayantilal Katakia a partner of the appellants was the Chairman of the company until August 22, 1969. His two brothers were also Directors of the company since its inception till August 22, 1969. The Bombay group had also Directors of the company.

25. The company proved the unanimous resolution of the Board at a meeting held on June 21, 1969, for sale of machinery of the company. The Katakia Brothers were present at the meeting. The Katakia Brothers there after sold their three shares to the Valia group. The cumulative evidence in support of the case of the company is not only that the Katakia Brothers consented to and approved of the sale of machinery but also parted with their shares of the company. The three shares were sold by the Katakia Brothers shortly after each of them had written a letter on July 27, 1969, expressly stating that they had no objection to the sale of the machinery and the letter was issued in order to enable the company to hold an Extra-ordinary General meeting on the subject. The company relied on the resolution of the Board meeting on October 24, 1969, where it was recorded that the Valia group would sell their 367 shares and 3 other shares which they had purchased from the appellants to the Nandkishore group and the appellants would accept Rs. 14,850/- in settlement of the sum of Rs. 72,000/- due from the company and the company would make that payment out of proceeds of sale of the machinery. The Board at a meeting held on September 17, 1969, resolved that the proposal of R. K. Khanna to purchase the machinery be accepted. On December 20, 1969, an agreement was signed between R. K. Khanna and the company for the sale of the machinery. At the Annual General Meeting of the company of January 8, 1970, the Resolution for sale of the machinery was unanimously passed by the company.

26. It is in this background that the appellants impeached the proposed sale of the machinery as unauthorised and improvident. The appellants themselves were parties to the proposed sale. The appellants themselves wanted to buy the machinery at a higher figure. These matters are within the

province of the management of the company. Where the shareholders have approved of the sale it cannot be said that the transaction is unauthorised or improvident according to the wishes of the shareholders.

27. It will appear from the judgment of the High Court that the creditors for the sum of Rs. 7,50,000/- supported the company and resisted the appellants' application for winding up. There was some controversy as to whether all the creditors appeared or not. At the hearing of this appeal the company gave a list of the creditors and notices were issued to the creditors. Apart from the appellants, two other creditors who supported the appellants were Ravi Industries Ltd., whose name appears as one of the creditors as on August 2, 1971, in the list of creditors furnished by the company and K. S. Patel and Co., with a claim of Rs. 44,477.56 though their name does not appear in the list. Among the creditors who supported the company the largest amount was represented by Nandkishore and Company with a claim for Rs. 4,95,999/-. The two creditors who supported the claim of the appellants in regard to the prayer for winding up were Ravi Industries Ltd., with a claim of Rs. 2,97,500/- on account of rent and K. S. Patel and Co. of Bombay with a claim for Rs. 44,477.56. It may be stated here that this claim of Rs. 44,477.56 was made on account of erection work of machinery and this identical claim was included in the list of expenses claimed by the appellants on account of erection work. The company disputed the claim. The High Court correctly found that the appellants could not sustain the claim to support winding up. It is surprising that a claim of the year 1965, was never pursued until it was included as an item of debt in the petition for winding up the company. With regard to the claim for rent, the company pursuant to an agreement between the company and Ravi Industries Private Ltd. credited Rowe Industries with the sum of Rs. 1,52,000/- with the result that the sum of Rs. 1,45,500/- would be payable by the company to Ravi Industries Ltd. in respect of rent. The company alleges that Ravi Industries Private Ltd. supported the company in the High Court and that they have taken a completely different position in this Court. In this Court the company has also relied on a piece of writing, dated September 24, 1971, wherein Ravi Industries Private Ltd. acknowledged payment of Rs. 1,52,000/- to Rowe Industries Private Ltd. and the further agreed to write off the amount of Rs. 1,45,500/-. Ravi Industries Private Ltd. is disputing the same. This appears to be a matter of substantial dispute. The court cannot go into these questions to settle debts with doubts.

28. Counsel for the appellants extracted observations from the judgment of the High Court that it was never in dispute that the company was insolvent and it was therefore contended that the company should be wound up. Broadly stated, the balance-sheet shows the share capital of the company to be Rs. 5,51,500/-, the liabilities to be Rs. 9,77,829.77 and the assets to be Rs. 8,87,177.93. The assets were less than the liability by Rs. 90,000/-. Accumulated losses of the company for five years appear to be Rs. 6,21,177.53. The plant and machinery which are shown in the balance-sheet at Rs. 6,07,544.58 are agreed to be sold at Rs. 4,50,000/-. There would then be a shortfall in the value of the fixed assets by about Rs. 1,50,000/- and if that amount is added to the sum of Rs. 90,000/- representing the difference between the assets and liabilities the shortfall in the assets of the company would be about Rs. 2,50,000/-.

29. The appellants contended that the shortfall in the assets of the company by about Rs. 2,50,000/- after the sale of the machinery would indicate first that the substratum of the company was gone and secondly that the company was insolvent. An allegation that the substratum of the company is gone is to be alleged and proved as a fact. The sale of the machinery was alleged in the petition for winding up to indicate that the substratum of the company had disappeared. It was also said that there was no possibility of the company doing business at a profit. In determining whether or not the substratum of the company has gone, the objects of the company and the case of the company on

that question will have to be looked into. In the present case the company alleged that with the proceeds of sale the company intended to enter into some other profitable business. The mere fact that the company has suffered trading losses will not destroy its substratum unless there is no reasonable prospect of it ever making a profit in the future, and the court is reluctant to hold that it has no such prospect. See *Re. Suburban Hotel Co.*, ((1867) 2 Ch App 737.) and *the Davis and Co. v. Brunswick (Australia) Ltd.* ((1936) 1 AER 299.) The company alleged that out of the proceeds of sale of the machinery the company would have sufficient money for carrying on export business even if the company were to take into consideration the amount of Rs. 1,45,000/- alleged to be due on account of rent. Export business, buying and selling yarn and commission agency are some of the business which the company can carry on within its objects. One of the Directors of the Company is Kishore Nandlal Shah who carries on export business under the name and style of M/s. Nandkishore and Co. in partnership with others. Nandkishore and Co. are creditors of the company to the extent of Rs. 4,95,000/-. The company will not have to meet that claim now. On the contrary, the Nandkishore group will bring in money to the company. This Nandkishore group is alleged by the company to help the company in the export business. The company has not abandoned objects of business. There is no such allegation of proof. It cannot in the facts and circumstances of the present case be held that the substratum of the company is gone. Nor can it be held in the facts and circumstances of the present case that the company is unable to meet the outstandings of any of its admitted creditors. The company has deposited in the court the disputed claims of the appellants. The company has not ceased carrying on its business. Therefore, the company will meet the dues as and when they fall due. The company has reasonable prospect of business and resources.

30. Counsel on behalf of the company contended that the appellants presented the petition out of improper motive. Improper motive can be spelt out where the petition is presented to coerce the company in satisfying some groundless claims made against it by the petitioner. The facts and circumstances of the present case indicate that motive. The appellants were Directors. They sold their shares. They went out of the management of the company in the month of August, 1969. They were parties to the proposed sale. Just when the sale of the machinery was going to be effected the appellants presented a petition for winding up. In the recent English decision in *Mann and Another v. Goldstein and Another*, ((1968) 1 WLR 1091.) it was held that even though it appeared from the evidence that the company was insolvent, as the debts were substantially disputed the court restrained the prosecution of the petition as an abuse of the process of the court. It is apparent that the appellants did not present the petition for any legitimate purpose.

31. The appeal therefore fails and is dismissed with costs. The company and the supporting creditors will get one hearing fee. The amount of Rs. 72,000/- which was deposited in court will remain deposited in the court for a period of eight weeks from this date and if in the meantime no suit is filed by the appellants within eight weeks the company will be at liberty to withdraw the amount by filing the necessary application. In the event of the suit being filed within this period the amount will remain to the credit of the suit.

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