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BHAGWATI DEVELOPERS

v.

PEERLESS GENERAL FINANCE & INVESTMENT CO. LTD.  
AND ORS.

AUGUST 9, 2005

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[S.N. VARIAVA AND DR. AR. LAKSHMANAN, JJ.]

*Companies Act, 1956 :*

C

*S. 205—Issue of Bonus Shares—Permissibility of—Peerless General Finance and Investment Company—Article of Association—Articles 2 and 182—Company issuing bonus shares out of Revaluation Reserve—Held, Companies Act specifically permits utilization of reserve arising from revaluation of assets for purpose of issuing fully paid up bonus shares—Accordingly, Article 182 authorises the Company to issue Bonus Shares out of reserve arising from revaluation of capital assets.*

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**Reserve Bank of India issued directions to investment companies, *inter alia*, that depositors' monies must be shown in their balance-sheets as a "liability" instead of income. Accordingly, Respondent No. 1, being such investment company, become liable to transfer certain amount to depositors' Account by debiting the Profit and Loss Account with the equal amount. The Reserve Bank of India asked the respondent to prepare its balance-sheet in conformity with its directions. In order to increase the share capital, the company proposed to issue Bonus Shares out of Revaluation Reserve. The appellant, one of the share-holders of the Company, challenged the move the respondent by filing a suit for declaration that the respondent was not entitled to issue Bonus Shares out of Revaluation Reserve. He later filed an appeal before the High Court and prayed for an injunction restraining the respondent from issuing Bonus shares. The appeal was disposed of by the Division Bench of the High Court holding that the respondent was entitled to issue Bonus shares out of Revaluation Reserve. Aggrieved, the share-holder filed the present appeal.**

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**Dismissing the appeal, the Court**

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**HELD : 1.1. Section 205 of the Companies Act, 1956 provides that the dividend could only be issued out of profits of the company. The**

proviso to sub-s.(3) of s.205 permits capitalization of profits or reserve of a company for the purpose of issuing fully paid up bonus shares or paying up any amount for the time being unpaid or any shares held by the members of the company. Thus the Companies Act specifically permits utilization of reserve arising from revaluation of assets for purpose of issuing fully paid up bonus shares. When the law so permits, Articles 182 of Articles of Association of the respondent-company authorizes the company to issue Bonus shares out of reserves arising from revaluation of capital assets. [509-C-E]

1.2. The word 'dividend' as defined in Article 2 of Articles of Association of the Company includes 'bonus'. Thus the words 'available for dividends' appearing in Article 182 would necessarily mean "available for dividend/bonus". Further, the words, "available for dividends" would be applicable to all categories of funds mentioned in the said Article. Thus, even though the interpretation given by the High Court on Article 182 is not correct, still the final conclusion that Article 182 does not prohibit issuance of Bonus shares is correct and requires no interference. [507-F-G; 509-A-B; D-E]

\**Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India*, [1992] 2 SCC 343, referred to.

2. The SEBI guidelines, which have been relied upon by the appellant, were clarified on 13th August, 1992 wherein it has been stated that these guidelines do not apply to issue of securities by existing private/closely held and other unlisted companies. In view of this clarification, there is no infirmity in the impugned judgment wherein it has been held that the SEBI guidelines were not applicable to the Respondent Company. [506-F-G]

3. There is nothing wrong in the observation, in the impugned judgment, to the effect that the Circular dated 6th September, 1994 does not have any mandatory effect. This circular is merely advisory in character.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 12640 of 1996.

From the Judgment and Order dated 23.8.95 of the Calcutta High Court in A. No. 665 of 1994.

C. Mukund, Ashok Jain, Pankaj Jain and Bijoy Kumar Jain for the

A Appellant.

Ashok Desai, Bhaskar P. Gupta, Abhijit Chatterjee, S. Sukumaran, A. Deb Kumar, Ramesh Babu M.R., Ms. Radha Rangaswamy and Pradeep Kumar Malik for the Respondents.

B The Judgment of the Court was delivered by

S. N. VARIAVA, J. : This Appeal is against the Judgment dated 23rd August, 1995 passed by the Calcutta High Court.

C Briefly stated the facts are as follows:

D The Respondents are an Investment Company. The Reserve Bank of India had issued certain directions to them. The Respondents had challenged the authority and power of the Reserve Bank of India to issue such directions. That challenge ultimately culminated in this Court. By the Judgment reported in [1992] 2 SCC 343 [*Peerless General Finance and Investment Co. Limited v. Reserve Bank of India*] this Court held that the Reserve Bank of India had authority and power to issue direction in order to provide stable, identifiable and monitorable method of operation. This Court held that such directions would ensure security to the depositors at all times and also make the account of the company accurate, accountable and easy to monitor. This Court held that the directions given by the Reserve Bank of India were just, fair and reasonable not only to the depositors but, in the long run, to the very existence of the Respondent Company and its continued business itself. One of the directions was that the depositors' monies must be shown, in their balance sheets, as a "liability" instead of "income" as had been done by the Respondent Company. As this Court held that the directions issued by the Reserve Bank of India were valid the Respondents became liable to transfer Rs. 217.34 crores to the Depositors' A/c by debiting the Profit & Loss A/c with Rs. 217.34 crores. The Reserve Bank of India had, by a letter dated 11th March, 1992, called upon the Respondents to prepare its Balance Sheet in conformity with its earlier directions. It seems that the Respondent Company did not immediately comply with this direction but instead took a long period to show the Depositors' money as liability.

H The Respondent Company issued a notice calling for an A.G.M. to consider increasing the share capital of the company from Rs. 3 crores divided into 3,00,000 Equity Shares of Rs. 100 each to Rs. 35 crores divided

into 35,00,000 Equity Shares of Rs. 100 each. The Notice also provided as follows: A

“RESOLVED”

- (a) That pursuant to the provisions of Article 182(1) of the Articles of Association of the Company, a sum of Rs. 31,08,36,000 out of Rs. 73,82,87,261.60p. standing to the credit of Revaluation Reserve as per the Audited Accounts for the financial year ending on 31st March, 1994, be capitalized and accordingly, the Directors of the Company be and are hereby authorized and directed to appropriate the said sum of Rs. 31,08,36,000 to and amongst the members of the Company whose names shall appear on its Register of Members on 7th November, 1994 being the Record Date for this purpose (hereinafter called “the said date”) in proportion to the Equity Shares held by them respectively in the Company as on the said date and to apply the said sum of Rs. 31,08,36,000 in paying up in full of the unissued Equity Shares of the Company of Rs. 100 each at par, such shares (hereinafter referred to as the “Bonus Shares”) be allotted, distributed and credited as fully paid up to and amongst such members in proportion of 15 (Fifteen) Bonus Shares for every existing Equity Share held by them respectively as on the said date and that the Bonus Shares so distributed shall, for all purposes be treated as an increase in the nominal amount of the Capital of the Company held by each such member and not as income. B  
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- (b) That the Bonus Shares so allotted shall always be subject to the terms and conditions contained in the Memorandum and Articles of Association of the Company and the Guidelines for Bonus Shares issued by SEBI. F
- (c) That such allotment of Bonus Shares to non-resident shareholders of the Company shall be subject to the approval of the Reserve Bank of India under the Foreign Exchange Regulation Act, 1973, if any. G
- (d) That the Bonus Shares so allotted pursuant to this resolution shall rank in all respects *pari passu* with the existing fully paid H

**A** Equity Shares of the Company and shall also be entitled for the dividend in respect of the financial year ending on 31st March, 1995.

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xxx”

**B** The Appellant, who is one of the shareholders of the Company, filed a Suit against the Respondents for a declaration that they are not entitled to issue Bonus Shares out of Revaluation Reserve. In the Suit it was prayed that the impugned notice be cancelled. The Appellant applied for interlocutory injunction which was refused by a single Judge. The Appellants then filed a Letters Patent Appeal. The Appellate Court also did not grant an injunction. It only directed that the resolution passed at the Meeting would abide by the result of the Appeal. Accordingly the Meeting was held. The Appellant attended and objected to the Resolution being passed. But the Resolution was passed by a majority. The Appeal was subsequently withdrawn by the Appellant with a liberty to file a fresh Appeal. The Appellant then filed a fresh Appeal, wherein he applied for an injunction restraining the Respondents from issuing the Bonus Shares. The Division Bench of the Calcutta High Court permitted the Respondents to process all formalities but not to effect the delivery of the Bonus share scrips without obtaining prior leave of the Court. This Court refused to interfere in the Special Leave Petition filed by the Appellant but directed the High Court to dispose of the Appeal expeditiously. The Appeal was then disposed of by the impugned Judgment wherein it has been held that the Respondents were entitled to issue Bonus Shares out of Revaluation Reserve.

**F** The Appellant challenges the power of the Respondent Company to issue Bonus Shares out of Revaluation Reserve on three grounds viz. (a) that the Bonus Shares had been issued contrary to SEBI guidelines, (b) their issue is contrary to the Circular of the Department of Company Affairs dated 6th September, 1994 and (c) that the issue could not have been made as it is contrary to Article 182 of the Articles of Association of the Company.

**G** The SEBI guidelines, which have been relied upon, were clarified on 13th August, 1992 wherein it has been stated that these guidelines do not apply to issue of securities by existing private/closely held and other unlisted companies. In view of this clarification, we see no infirmity in the impugned Judgment wherein it has been held that the SEBI guidelines were not applicable to the Respondent Company.

**H**

We are also in agreement with the observation, in the impugned Judgment, to the effect that the Circular dated 6th September, 1994 does not have any mandatory effect. These Circulars are merely advisory in character. A

The relevant portion of Article 182 of the Articles of Association of the Company which has been strongly relied upon reads as follows: B

“182.(1) Any General Meeting may resolve that any amounts standing to the credit of the shares premium account or the Capital Redemption Reserve Account or any monies, investments or other assets forming part of the undivided profits including profits or surplus monies arising from the realization and (where permitted by law from the appreciation in value of any capital assets of the Company) standing to the credit of the General Reserve, Reserve or any Reserve Fund or any other Fund of the Company or in the hands of the Company and available for dividend by capitalized :- C

- (i) by the issue and distribution as fully paid up of shares, debentures, debenture stock, bonds or other obligations of the Company, or D
- (ii) by crediting shares of the Company which may have been issued and not fully paid up, with the whole or any part of the sum remaining unpaid thereon. E

Provided that any amounts standing to the credit of the share premium account or the Capital Redemption Reserve Account shall be applied only in crediting the payment of capital on shares of the Company to be issued to members (as herein provided) as fully paid bonus shares. F

xxx	xxx	xxx
xxx	xxx	xxx”

Reference must also be made to the definition of “Dividend” under Article 2, wherein it has been stated that the word “Dividend” includes “Bonus”. On behalf of the Appellant it has been submitted that Article 182 permits capitalization of profits by issuance and distribution of fully paid up shares, debentures, debenture stock amongst others out of the Revaluation of Capital Assets only in such cases where the “funds are available for dividends”. It was submitted that the words “available for dividends” under G H

- A Article 182 cover all the categories of funds which could be capitalized for the purpose of issue of fully paid up shares. It was submitted that any fund which was not available for dividend could not be used for purposes of issue of fully paid up shares. Reliance was then placed upon Article 175 wherein it was provided that no dividend would be payable except out of profits arising from the business of the company. It was submitted that both the
- B Articles have to be read together and, if read together, it is clear that dividends as well as issue of fully paid up shares could only be made out of profits arising from the business of the company and not from the revaluation of capital assets. It was submitted that the High Court erred in holding that the words “available for dividends” only applied to words “other funds of the
- C company or in the hands of the company” and that it did not apply or restrict the other categories laid down under Article 182.

- D On the other hand, on behalf of the Respondents it is submitted that the High Court was right in coming to the conclusion that the words “available for dividends” did not apply to any other categories except the category of funds of the company in the hands of the company.

- E Both sides have also relied on various provisions of the Companies Act, some other Articles in the Articles of Association and various authorities. In our view it is not necessary to set those out or deal with them as the decision will have to be based on an interpretation of Article 182. For consideration of the rival arguments Article 182 would have to be broken up in the following manner:

- F “Any General Meeting may resolve that any amounts standing to the credit of

- (a) Share Premium Account,
- (b) Capital Redemption Reserve Account and
- G (c) any monies, investments of other assets forming part of the undivided profits including profit or surplus monies arising from (i) realization and (ii) where permitted by law, from the appreciation in value of any capital assets standing to the credit of General Reserve, Reserve or any Reserve Fund or any other Fund of the Company or in the hands of the Company and
- H available for dividends.”

If read in this manner it is clear that the words “available for dividends” would be applicable to all categories. The High Court was thus wrong in concluding that these words only applied to the last category i.e. funds of the company or in the hands of the company. However, it must be seen that the word “Dividend” wherever it appears in the Articles also includes “Bonus”. Thus the words “available for dividends” would necessarily mean “available for dividend/bonus”. Article 182 itself provides that where the law permits issuing of bonus from appreciation of value in the capital assets the same could be done. If read in the manner suggested by the Appellants this portion of Article 182 i.e. issuing of bonus out of Revaluation Reserves would be rendered otiose. So would certain other portions of Article 182 viz. the provision regarding issuing of bonus out of Share Premium Account and Capital Redemption Reserve Account. Section 205 of the Companies Act provides that the dividend could only be issued out of profits of the company. The proviso to sub-section 3 of Section 205 permits capitalization of profits or reserve of a company for the purpose of issuing fully paid up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company. Thus the Companies Act specifically permits utilization of reserve arising from revaluation of assets for purpose of issuing fully paid up bonus shares. When the law so permits, Article 182 authorizes the company to issue Bonus shares out of reserves arising from revaluation of capital assets. Thus, even though the interpretation given by the High Court on Article 182 is not correct, still the final conclusion that Article 182 does not prohibit issuance of Bonus shares is correct and requires no interference. It was next submitted on behalf of the Appellant that as the directions of the Reserve Bank of India had not been complied with the balance sheet of the Company did not reflect the true picture and in actual fact when the bonus shares were sought to be issued the Company was in a loss. On the other hand it was submitted on behalf of the Respondents that the Company had complied with the directions and had been granted time of 7 years to regularize its accounts. In our view it is not necessary for us to go into this controversy as it will always be open to the Reserve Bank of India to take such action as is available to it in law, if it feels that its directions were not complied with.

In this view of the matter, we see no reason to interfere. The Appeal stands dismissed. There will be no order as to costs.

R.P.

Appeal dismissed.