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Compliances to be undertaken for sale of an undertaking

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Corporate Law Services Group
11th November 2015

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The Companies Act imposes some restrictions on the general powers of directors. Pursuant to section 180 of Companies Act, 2013 (“Act, 2013”), there are certain powers which the board of directors of a company can exercise only with the consent of the members of the company by means of a special resolution. In this article, sub-clause (a) of sub-section (1) of section 180 of the Act, 2013 has been discussed at length to ascertain the meaning of ‘undertaking’ and compliances to ensure at the time of sale, lease or disposal of undertaking.

The text of the said clause is as follows:

(1) The Board of Directors of a company shall exercise the following powers only with the consent of the company by a special resolution, namely:—

to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.

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Further, the selling of undertaking(s) being crucial and of concern to the members of a company, in order to encourage wider participation of the members in the matter, pursuant to section 110(1)(a) of Act, 2013 read with Rule 22(16)(i) of the Companies (Management and Administration) Rules, 2014, the said item of business shall have to be transacted only by means of voting through postal ballot.

Here, it is pertinent to read the language of the said rule minutely:

(16) pursuant to clause (a) of sub-section (1) of section 110, the following items of business shall be transacted only by means of voting through a postal ballot-

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(i) sale of the whole or substantially the whole of an undertaking of a company as specified under sub-clause (a) of sub-section (1) of section 180;

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This means that although sub-clause (a) of sub-section (1) of section 180 pertains to ‘to sell, lease, or otherwise dispose of’ the whole or substantially the whole of undertaking(s), postal ballot is required only in case ‘selling’ of the whole or substantially the whole of undertaking(s).

Prior approval from the members

Although the word ‘prior’ does not appear in the section, but it is very clear that the consent of the members has to be sought prior to the act of selling, leasing or otherwise disposing of the whole or substantially the whole of the undertaking(s) of the company.

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The powers under this section can be exercised by the board only with the consent of the general body. The board cannot exceed the powers in the hope that the general body will ratify their actions. Accordingly, the power shall be exercisable only with the prior consent of the members.

Approval of Audit Committee

Pursuant to section 177(4)(vi) of the Act, 2013, the undertaking and asset of a company needs to be valued by the audit committee, wherever it is necessary.

Section 180(1)(a) of Act, 2013 vis-à-vis Section 293(1)(a) of Companies Act, 1956

It is pertinent to note that section 180(1)(a) of Act, 2013 corresponds to section 293(1)(a) of the Companies Act, 1956.

Similar provision contained in the Act, 1956 except with the following differences:

1. Earlier ordinary resolution from the members would suffice as compared to the requirement of special resolution from the members in Act, 2013.
2. Section 293(1)(a) of Act, 1956 was applicable to public and deemed public companies while Section 180(1)(a) was initially applicable to all companies. However, MCA vide exemption notification dated 5th June, 2015 rendered section 180 inapplicable to private companies.
3. The expression “substantially the whole of the undertaking” and “undertaking” has been defined in section 180 of Act, 2013

Interpretation of the word “undertaking”

Explanation (ii) to section 180(i)(a) defines the meaning of the expression “undertaking”.

Explanation.—For the purposes of this clause,—

(i) “undertaking” shall mean an undertaking in which the investment of the company exceeds twenty per cent of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent of the total income of the company during the previous financial year;

Primarily, for a transaction to be considered within the purview of Section 180(1)(a) of Act, 2013, it has to comply with the following criteria –

- should relate to an “undertaking”; and
- should be in respect of sale, lease or disposal of such ‘undertaking’ in any other manner.

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In the Act, 1956, section 293(1)(a) also gave a very similar rendition; however, it did not furnish any explanation to what an ‘undertaking’ meant. The explanation to section 180(1)(a) of Act, 2013 furnishes only the qualifying criteria of an ‘undertaking’ to be considered under section 180(1)(a), but does not actually define an ‘undertaking’.

For the purpose of concluding on what classifies as an ‘undertaking’ under Section 180(1)(a) of Act, 2013, we thereby have to look to various Court rulings to understand the precedents set by the Courts in relation to what constituted as ‘undertaking’ under Section 293(1)(a) of Act, 1956.

In the decision of *Rustom Cavasjee Cooper vs Union of India*¹, the Apex Court provided an insight into what could constitute an ‘undertaking’. The case, amongst other matters, pertained to interpretation of undertaking for the purpose of Section 4 of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969. Although, the case did not pertain to only interpreting undertaking as per Section 293(1)(a) of Act, 1956, it still offered a detailed discussion on this front. The Supreme Court held that by the word ‘undertaking’ is meant the entire organization. The provisions of the stated Act, indicate that the company whether it has a plant or whether it has an organization is considered as one whole unit and the entire business of the going concern is embraced within the word ‘undertaking’. It also held that ‘undertaking’ would clearly mean a going concern with all its rights, liabilities and assets-as distinct from the various rights and assets which compose it for the purposes of the stated Act.

Looking further, the Karnataka High Court, in the case of *International Cotton Corpn. (P.) Ltd. v. Bank of Maharashtra*², referred to the case of *Madras Gymkhana Club Employee's Union v. Management*³ to conclude that the business of the company or undertaking of the company must be distinguished from the other properties belonging to the company. In *Madras Gymkhana* (supra) the meaning of undertaking was further defined to mean “any business or any work or project which one engages in or attempts as an enterprise analogous to business or trade”.

The concept of ‘undertaking’ may also be derived from the explanation stated under section 2(19AA) of Income Tax Act, 1961, wherein it has been defined to include:

“any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.” (emphasis supplied)

Also, ‘undertaking’ is defined in section 2(v) of the Monopolies and Restrictive Trade Practices Act, 1969

“undertaking” means an enterprise which is, or has been, or is proposed to be, engaged in the production, storage, supply, distribution, acquisition or control of articles or

¹ Read the entire text of the ruling at : <http://www.indiankanoon.org/doc/513801/>

² Read the entire text at : <http://www.indiankanoon.org/doc/1420687/>

³ Read the entire text at : <http://www.indiankanoon.org/doc/1420687/>

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goods, or the provision of services, of any kind, either directly or through one or more of its units or divisions, whether such unit or division is located at the same place where the undertaking is located or at a different place or at different places.

Explanation I: *In this clause-*

(a) *"article" includes a new article and "service" includes a new service;*

(b) *"unit" or "division", in relation to an undertaking includes-*

(i) *a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods;*

(ii) *any branch or office established for the provision of any service.*

Explanation II: *For the purposes of this clause, a body corporate, which is, or has been, engaged only in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate shall be deemed to be an undertaking.*

Explanation III: *For the removal of doubts, it is hereby declared that an investment company shall be deemed, for the purposes of this Act, to be an undertaking;*

Numerical definition of “undertaking”

Delving further into the Act, 2013 Section 180(1)(a) also places a numerical definition to the term ‘undertaking’, rendering that even if the asset(s) can be said to be an operating unit or segment, the asset(s) will have to qualify the numerical test given in the Explanation below the said Section; which is, ‘undertaking’ to mean an investment which constitutes either 20% of the net worth or total income of the company during the previous financial year.

Illustration

Accordingly, in case of selling of a leasehold estate by a company which is not used by the company in its ordinary course of business, the same shall not be considered to be selling of the undertaking. The rationale of such understanding is that by generic meaning, a ‘leasehold estate’ is basically a temporary right to hold such property in which the lessee or the tenant holds rights of real property by some form of title from the lessor, i.e., owner of the property. Hence, the company only has a beneficial ownership and not freehold or outright ownership on the said property. As derived earlier from the Court rulings, the business or undertaking(s) of the company must not be equated with the other properties belonging to the company. Accordingly, since such leasehold asset is not owned by the company and further, is also neither used for any business purpose of the Company, nor used for generating any productive income. Therefore, evidently, the said leasehold property does not fall within the very definition of the term ‘undertaking’.

What can be deduced from the discussion above, the very concept of ‘undertaking’ would essentially mean –

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- an asset or group of assets, where the sole ownership right(s) is with the company; and
- which when disposed of can have an impact on the working of the company and earning of its profits.

Meaning of the expression “otherwise dispose of”

The expression “otherwise dispose of” has to be read in a wider sense so as to cover all modes of disposing of a property of the company.

Earlier the Department of Company Affairs vide letter dated 21.7.1964, clarified that in case a company mortgages the whole or substantially the whole of its undertaking for obtaining loans or financial assistance, it need not comply with the erstwhile section 293(1)(a). However, in case of an usufructuary mortgage, the section would be attracted.

Further, in the decision of *Mohanlal Ganpatram vs Shri Sayaji Jubilee Cotton And ... on 18 February, 1964*⁴, execution of equitable mortgages (also known as mortgage by deposit of title-deeds) and pledges is not disposition of the whole or substantially the whole of the undertaking of the company.

Also, the ‘business’ or ‘undertaking’ of the company must be distinguished from the ‘properties’ belonging to the company. Where only the properties belonging to the company have been dealt with by the board of directors under the deeds of hypothecation and mortgage in favour of the bank, no part of the undertaking of the company should be considered to be disposed of in favour of the bank. [Reference – decision of Karnataka High Court in the matter of *International Cotton ... vs Bank Of Maharashtra And Anr. on 11 April, 1969*⁵].

Conclusion

While Act, 2013 provides a quantitative classification for identifying the undertaking, one has to refer precedents laid by the Courts while ascertaining the meaning of undertaking and accordingly ensure compliance under Act, 2013.

References:

1. For our articles on Companies Act, 2013 you may see: http://www.india-financing.com/images/Articles/MCAs_clarification_on_section_180.pdf

⁴<http://indiankanoon.org/doc/1774726/>

⁵<http://indiankanoon.org/doc/1420687/>