

Undertaking: A Judicial Perspective

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This article focuses on clause (a) of sub-section (1) of section [180](#) of the Act, which relates to approval of shareholders by special resolution where the board resolves 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. This article is a compilation of interpretation of the term 'undertaking' by various Court in India. The concept of 'undertaking' is of great significance under the Companies Act, as it defines the scope of the powers of the board of directors in relation to the shareholder's approval

Introduction Restrictions on powers of board of directors

1. Section 180 of the Companies Act, 2013 ('the Act') relates to 'Restrictions on powers of board of directors', whereby the Board of Directors of a company shall exercise certain powers only with the consent of the company by a special resolution. The powers of the board of directors are restricted w.r.t.: (a) 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 whole of any of such undertakings, (b) Invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation, (c) Borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium (apart from temporary loans obtained from the company's bankers in the ordinary course of business), (d) Remit or give time for the repayment of, any debt due from a director.

This article focuses on clause (a) of sub-section (1) of section 180 of the Act, which relates to approval of shareholders by special resolution where the board resolves 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. This article is a compilation of interpretation of the term 'undertaking' by various Court in India.

'Undertaking' & 'substantially the whole of the undertaking' under the Companies Act, 2013

2. The concept of 'undertaking' was not defined under the Companies Act, 1956. However, the same has been defined in the *Explanation* to clause (a) of sub-section (1) of section 180 of the Act.

- (i) The expression 'undertaking' means 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.
- (ii) The expression 'substantially the whole of the undertaking' in any financial year means twenty per cent or more of the value of the undertaking as per the audited balance sheet of the preceding financial year.

Undertaking means 'unit'

3. The Bombay High Court in *P.S. Offshore Inter Land Services (P.) Ltd. v. Bombay Offshore Suppliers & Services Ltd.* [[1992\] 75 COMP CASE 583](#) interpreted the expression 'undertaking' under the Companies Act, 1956 and stated that the expression 'undertaking' is liable to be interpreted to mean 'the unit', the business as a going concern, the activity of the company duly integrated with all its components in the form of assets and not merely some assets of the undertaking. The Bombay High Court stated as under:

- (i) Having regard to the object of the provision, it can, at the most, embrace within it all the assets of the business as a unit or practically all such constituents;
- (ii) If the question arises as to whether the major capital assets of the company constitute the undertaking of the company while examining the authority of the board to dispose of the same without the authority of the general body, the test to be applied would be to see whether the business of the company could be carried on effectively even after disposal of the assets in question or whether the mere husk of the undertaking would remain after disposal of the assets?
- (iii) The test to be applied would be to see whether the capital assets to be disposed of constitute substantially the bulk of the assets so as to constitute the integral part of the undertaking itself in the practical sense of the term;
- (iv) For the purpose of section [293\(1\)\(a\)](#) of the Companies Act, 1956 (Corresponding to section 180(1)(a) of Companies Act, 2013), all the capital assets of the undertaking taken together would be embraced by the expression 'undertaking', as otherwise it would be very easy to defeat the legislative intention and avoid procurement of the consent of the general body when the legislative intention is clear that the directors cannot dispose of the entire or substantially the whole business of the company without the consent of the general body;
- (v) If after disposal of practically all the capital assets of a company, what remains is only the husk of the assets, it would be perhaps difficult to take the view that, merely assets of the undertaking are disposed of and not the undertaking itself;
- (vi) It is, therefore, possible to take a view that the board of directors cannot dispose of 'all the capital assets of the company' taken together which will denude the company of its business or will leave merely the husk behind.

Whether 'sale of shares' amount to 'sale of undertaking'?

4. In a different case, the Bombay High Court in *C.D.S. Financial Services (Mauritius) Ltd. v. BPL Communications Ltd.* [[2004](#)].[56 SCL 665](#) stated as under:

- (i) The opening words of section 293(1)(a) of the Companies Act, 1956 (Corresponding to section 180(1)(a) of Companies Act, 2013) clearly show the legislative intent that whenever an undertaking is owned by the subsidiary, the section contemplates that a resolution shall be passed in the general meeting of the subsidiary company. The Legislature in enacting section 293 of the Companies Act, 1956 (Corresponding to section 180(1)(a) of Companies Act, 2013) has taken note of the situation where there would be a holding company and also subsidiary company. It is obvious from the language of the section that company which owns the undertaking has to pass the resolution in a general meeting;
- (ii) The Respondent Nos. 16 and 17 were the legal owners of the cellular telephone business. Even if business was equated with an undertaking, there was no transfer of the undertaking in as much as the business continued to belong to the subsidiaries, that is, Respondent Nos. 16 and 17;
- (iii) It is true that the modern tendency is where there is identity and community interest between the companies in the group, especially where they are related as holding company and wholly owned subsidiary or subsidiaries to ignore their separate legal entity and look instead at the economic entity of the whole group. On a proper reading of section 293(1)(a) of the Companies Act, 1956 (Corresponding to section 180(1)(a) of Companies Act, 2013), there was nothing in the language thereof which would compel to invoke the doctrine of lifting the corporate veil. In the facts of the instant case, there was no reason whatsoever to apply the said principle;
- (iv) The sale of shares cannot be equated with the sale of undertaking or any part thereof. There was no hesitation in holding that section 293(1)(a) of the Companies Act, 1956 (Corresponding to section 180(1)(a) of Companies Act, 2013) had no application to the instant case.

Whether 'transfer of controlling interest' can be equated with 'sale of undertaking'?

5. In a different case *Brooke Bond India Ltd. v. U. B. Ltd.* [[1994](#)].[79 Comp Case 346](#), the Bombay High Court held that the sale of shares, whatever be their number, even if it amounts to a transfer of the controlling interest of a company, cannot be equated with the sale of any part of the 'undertaking' so as to come within the mischief of section 293(1)(a) of the Companies Act, 1956 (Corresponding to section 180(1)(a) of Companies Act, 2013).

Undertaking vis-à-vis Tangible piece of property

6. The single judge of the Mysore High Court in *Yallamma Cotton, Woollen and Silk Mills Co. Ltd.*, In re [\[1970\] 40 Comp Case 466](#) held that "The word 'undertaking' is not in its real meaning anything which may be described as a tangible piece of property like land, machinery or the equipment; it is in actual effect an activity of man which in commercial or business parlance means an activity engaged in with a view to earn profit. Property, movable or immovable, used in the course of or for the purpose of such business can more accurately be described as the tools of business or undertaking, i.e., things or articles which are necessarily to be used to keep the undertaking going or to assist the carrying on of the activities leading to the earning of profits." While creating a floating charge on the undertaking, the lender-bank was also under the agreement empowered not merely to take possession as mortgagee for the purpose of realising its dues from out of the property expressly given to it as security but also to actually take over the management of the business of the company. The question was whether the clause was valid. The Mysore High Court held that "The said clause was invalid, because to permit the bank to take over the management of the company's business itself may be regarded as a disposal by the company of the whole of its undertaking to the bank. However, the invalidity of this one clause in the document need not be said to have a fatal effect on the entire transaction itself. This clause alone could be struck down to the extent it empowered the taking over of the management of the business of the company without affecting the validity of the enforceability of the rest of the terms."

Business or Undertaking of Company vis-à-vis property

7. The High Court of Mysore in *International Cotton Corporation (P.) Ltd. v. Bank of Maharashtra* [\[1970\] 40 Comp Case 1154](#) held that "Section 293(1)(a) of the Companies Act, 1956 (Corresponding to section 180(1)(a) of Companies Act, 2013) will apply when the whole or substantially the whole of the undertaking of the company is sold, leased or otherwise disposed of. Webster's New Standard Dictionary described the word 'undertaking' as meaning a business or project engaged in. The word 'undertaking' has been defined as 'any business or any work or project which one engages in or attempts as an enterprise analogous to business or trade'. The business or undertaking of the company must be distinguished from the properties belonging to the company. Properties of company are distinct from undertaking and hypothecation of properties does not amount to disposal of undertaking. The word 'undertaking' has been defined as 'any business or any work or project which one engages in or attempts as an enterprise analogous to business or trade'. The business or undertaking of the company must be distinguished from the properties belonging to the company."

'Sale of undertaking' under sections 391 - 394 of the Companies Act, 1956

8. With respect to the 'sale of undertaking' under sections [391](#) - [394](#) of the Companies Act, 1956 (instead of Section 180(1)(a) of the Companies Act,

2013, read with Section 293(1)(a) of the Companies Act, 1956), the Karnataka High Court in *United Spirits Ltd., In re Co. Petition No. 170 of 2014* dated February 19, 2015 made the following observations:

- (i) Sections 391 to 394 of the Companies Act, 1956 are a complete code. It contains various powers of the company court in dealing with the scheme of amalgamation or reconstruction that is proposed before it. It deals with each and every aspect that the Company Court should consider before approving of the scheme of amalgamation;
- (ii) Therefore, to hold that section 180 of the Companies Act, 2013 is applicable, only because the same involves the sale of the company, would be incorrect. Section 180 of the Companies Act, 2013 deals with the powers of the board of directors to sell, lease or otherwise dispose off the whole or substantially the whole of the undertaking that would necessarily involve the sale of the undertaking also. Such a sale of the undertaking or such a lease or otherwise or disposal of the whole or substantially the whole of the company is very well defined under the provisions of sections 391 to 394 of the Companies Act, 1956;
- (iii) When it is held that sections 391 to 394 are a Code by itself necessarily it would have precedence over the other provisions of the Act. It is not the case where the provisions of section 180 of the Companies Act, 2013 are not being complied with and the scheme is sought to be sanctioned otherwise than in accordance with law;
- (iv) What is sought for is necessarily the sanction of the company court in terms of sections 391 to 394 of the Companies Act, 1956. Therefore, it cannot be said that the non-compliance of section 180 of the Companies Act, 2013 would run contrary to the provisions of sections 391 to 394 of Companies Act, 1956. In view of the judicial pronouncements of the High Court's as well as the Supreme Court reiterating the fact that sections 391 to 394 of the Companies Act, 1956 are a code, thereby other provisions of the statute not forming part and parcel of the Code, necessarily the provisions of these sections would have precedence over the other provisions of the Act;
- (v) The Court relied on the Bombay High Court's ruling in the case of *PMP Auto Industries Ltd. In re [1994] 80 Comp Case 289*, wherein it was held that once a scheme of arrangement falls within the ambit of sections 391 to 394 of the Companies Act, 1956, the same could be sanctioned even if it involves doing acts for which the procedure is specified under other sections of the Companies Act;
- (vi) Therefore, it cannot be said that the scheme as propounded by the petitioner is a scheme that does not fall under sections 391 to 394 of the Companies Act, 1956 but exclusively under the provisions of section 180 of the Companies Act, 2013. The contentions regarding the applicability of section 180 of Companies Act, 2013 cannot be accepted. In the facts and circumstances of this case the provisions of section 293 of the Companies Act, 1956 or section 180 of the Companies Act, 2013 would not be applicable to the case herein. Sections 391 to 394 of the Companies Act, 1956 alone would be applicable herein.

Conclusion

9. The concept of 'undertaking' is of great significance under the Companies Act, as it defines the scope of the powers of the board of directors in relation to the shareholder's approval. It is equally important to understand whether sale of few assets of the company or sale of business of the company amounts to 'sale of undertaking' under the Companies Act, as it would determine the approval process for the transaction. As analyzed in the various judgments of the Courts, there are certain transactions which are 'sale of undertaking', whereas certain transactions don't qualify for being a 'sale of undertaking'. If the approval of appropriate authority (i.e., board of directors or shareholders) is not obtained for 'sale of undertaking', then the transaction would be *ultra vires* the powers of the company. However, nothing contained in clause (a) of sub-section (1) of section 180 of the Act shall affect: (i) Title of a buyer or other person who buys or takes on lease any property, investment or undertaking as is referred to in that clause, in good faith; or (ii) Sale or lease of any property of the company where the ordinary business of the company consists of, or comprises, such selling or leasing (Sub-section (3) of section 180 of the Companies Act, 2013.). A special resolution passed by the company consenting to the transaction as is referred to in clause (a) of sub-section (1) of section 180 of the Act may stipulate such conditions as may be specified in such resolution, including conditions regarding the use, disposal or investment of the sale proceeds which may result from the transactions. However, it shall not be deemed to authorise the company to effect any reduction in its capital, except in accordance with the provisions contained in the Companies Act (Sub-section (4) of section 180 of the Companies Act, 2013.).

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