



Verdict Vista



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NCLT allows the Conversion of a Company Limited by shares to a Company Limited by Guarantee under 'Arrangement'

Under the Companies Act, 2013 and the Companies (Incorporation) Rules, 2014 ('Companies Incorporation Rules, 2014'), there are several provisions for the conversion of a particular type/class of company into another type/class of company. A few important and relevant examples are as follows:

1. Rule 6 of the Companies Incorporation Rules, 2014 relates to the conversion of an OPC into a public company or private company,
2. Rule 7 of the Companies Incorporation Rules, 2014 relates to the conversion of a private company into an OPC,
3. Rule 21 of the Companies Incorporation Rules, 2014 relates to conditions for conversion of a company registered under section 8 into a company of any other kind,
4. Rule 37 of the Companies Incorporation Rules, 2014 relates to the conversion of an unlimited liability company into a limited liability company by shares or guarantee,
5. Rule 39 of the Companies Incorporation Rules, 2014 relates to the conversion of a company limited by guarantee into a company limited by shares.
6. Rule 41 of the Companies Incorporation Rules, 2014 relates to the conversion of a public company into a private company.

Interestingly, under the extant provisions, there is a specific provision for the conversion of a company limited by shares into a company limited by guarantee. This issue was before the NCLT, Bengaluru Bench. This article is an analysis of the NCLT order and its implications.

Facts of the case: An application was filed by Azim Premji Trust Services Private Limited ('Petitioner Company' / 'Transferor Company') for approval of the scheme of Arrangement under the provisions of Section 230 read with Section 18 and Section 66 of the Companies Act, 2013 and Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, for a conversion of the Petitioner Company from company limited by shares to a company limited by guarantee without share capital. According to the application made to the NCLT (Bengaluru Bench), the Petitioner Company stated that such conversion is permissible under Section 18 of the Companies Act.

Objections of the Registrar of Companies ('ROC'):

1. It was the contention of ROC that the corresponding Chapter II of the Companies (Incorporation) Rules, 2014, provides only for: (i) Conversion of an unlimited liability company into a limited liability company by shares or guarantee (Rule 37) and (ii) Conversion of a company limited by guarantee into company limited by shares (Rule 39). However, no rules have been provided for the conversion of a company limited by shares into a company limited by guarantee. Therefore, the ROC objected to taking recourse to provisions of Section 230 of the Companies Act for such conversion by way of a 'Scheme of Arrangement';
2. Another objection of the ROC is that u/s 66 (1) of the Companies Act, a company limited by shares or limited by Guarantee and having a share capital may, by a special resolution, reduce it in any manner;
3. Another observation of the ROC – In view of Section 4(1)(e) of the Companies Act, a company having share capital should hold a minimum of one share; and thus, the power u/s 66 of the Act can't be exercised to reduce the paid-up equity capital from Rs. 1,00,000/- to zero, as has been proposed by the company for conversion into a Company limited by Guarantee without having any capital.

Observations of NCLT (Bengaluru Bench): The observations of NCLT are summarised as follows:

1. NCLT noted that 'Company limited by guarantee' and 'Company limited by shares' have been defined under Section 2 (21) and 2 (22) of the Companies Act. NCLT observed that Rule 39 of the Companies (Incorporation) Rules, 2014 has been notified for "*Conversion of a Company Limited by guarantee into a company limited by shares*", and this Rule specifically confers powers on the Registrar of Companies, prescribed the relevant Form for filing the application within a time limit of 30 days before the ROC, and a further time limit of 30 days to the ROC to take a decision and accordingly issue necessary incorporation

certificate. NCLT observed that, however, no rules have been prescribed so far for allowing the conversion in the reverse direction, from a Company limited by shares into a company limited by guarantee;

2. NCLT stated that *“Merely because the rules have not yet been notified for the conversion of the company limited by shares into a company limited by guarantee, it does not mean that such conversion cannot be allowed when it is allowable under the provisions of Section 18 of the Companies Act, 2013. This is essentially covered within the scope of ‘arrangement’ between the company and its members, and under Section 2(21) of the Act, such a company limited by guarantee is prescribed for an undertaking to be given by the members to contribute to the assets of the Company in the event of its being wound up. Section 4(1)(d)(ii) of the Companies Act, 2013 also prescribes as to what was to be mentioned in the Memorandum of the company related to the guarantee undertaken by the members in respect of the company limited by guarantee”;*
3. NCLT concluded that *“In view of the facts and circumstances of the case, the Tribunal is of the considered opinion that the conversion as requested by the Company is liable to be allowed under the provisions of Section 230 of the Companies Act, read with Section 18 and Section 66 of the Companies Act, 2013 and read with Rule 11 of the NCLT Rules, 2016”*

Analysis & impact of NCLT Order allowing conversion of Company Limited by shares to Company Limited by Guarantee as ‘Arrangement’:

Chapter XV of the Companies Act (sections 230 to 240 of the Companies Act, corresponding to sections 390 to 396A of the Companies Act, 1956) covers aspects relating to compromise and arrangement. It also covers amalgamation or mergers, which is really one form of ‘arrangement’. The powers in respect of these matters were with the High Court (usually referred to as ‘Company Court’), however, these powers have been transferred to the National Company Law Tribunal (NCLT) under the Companies Act, 2013. As per the provisions of the law, the compromise, arrangement, and amalgamation/reconstruction require approval of the NCLT. Section 230 of the Companies Act deals with the basic procedures to be followed for any compromise and arrangement, meetings of creditors, members, and security holders for approval, and the powers of NCLT.

Based on the observations and conclusions in several judgments under the Companies Act, 1956, ‘Compromise’ means an amicable settlement of a dispute by mutual adjustments and concessions. In a ‘compromise’, each party has to yield and give some concessions. Compromise presupposes a dispute. In ‘arrangement’, there is no dispute, but it modifies rights, such as readjustment of rights may be with members or a class of them or creditors or a class of them. The term ‘arrangement’ is very wide and can include a re-organisation of capital.

The 'arrangement' or 'compromise' may be with creditors or members. This can take a variety of forms, e.g., creditors agreeing to waive part of their dues, converting part or all dues of creditors into shares, extending time for payment, reduction in capital by members, amalgamation, full or part transfer of undertaking, property, or liabilities of the company to another company, etc. According to the Explanation to section 230(1) of the Companies Act, 'arrangement' includes a reorganisation of the share capital of a company by consolidation of shares of different classes or by division of shares of different classes, or by both of the above methods.

In *Navjivan Mills Co. Ltd., In re* [1972] 42 Comp. Cas. 265 (Guj.), the High Court of Gujarat held that *“‘Compromise and arrangement’ covered by section 391 (of Companies Act, 1956) are of the widest character, ranging from a simple composition or moratorium to an amalgamation of various companies, with a complete reorganization of their share and loan capital. If this is the scope of section 391, it does appear that section 391 is a complete code by itself. There is inherent evidence which would support this conclusion. Whenever it was found necessary to provide that a particular thing such as reduction of share capital cannot be brought about by way of a scheme of compromise and arrangement unless special procedure prescribed for the same in section 100 onwards is carried out, a specific provision such as rule 85 (of the Rules made under Companies Act, 1956) was enacted for the purpose. The word ‘arrangement’ is such that, where even there is no dispute, arrangement can be brought in. ‘Compromise’ postulates the existence of a dispute and giving and taking on either side. ‘Arrangement’, on the other hand, is something by which parties agree to do a certain thing, notwithstanding the fact that there was no dispute between the parties. If such is the wide connotation of the word ‘arrangement’ as used in section 391, obviously, the arrangement by which shares of one company are taken over by the other company would not be outside the scope of the word ‘arrangement’. ‘Compromise and arrangement’ covered by section 391 are of the widest character, ranging from a simple composition or moratorium to an amalgamation of various companies, with a complete reorganisation of their share and loan capital. If this is the scope of section 391, it does appear that section 391 is a complete code by itself.”*

The NCLT order in the present case, *Azim Premji Trust Services Private Limited*, is quite relevant and important as it takes into consideration the extant provisions of the Companies Act and the Rules and notes that there is no specific provision for conversion of a company limited by share capital to a company limited by guarantee. Considering that the application was also made under section 66 of the Companies Act, the NCLT considered the relevant provisions of 'capital reduction', thereby allowing conversion of a company limited by shares to a company limited by guarantee. This precedent is also important from the perspective of the companies incorporated under section 8 of the Companies Act, and such a company is limited by shares. Such companies are not 'Small Companies' under section 2(85) of the Companies Act and hence the provisions of compulsory

dematerialisation are applicable (under Rule 9B of Companies (Prospectus and Allotment of Securities) Rules, 2014). Irrespective of the income earned, donations received, amount of share capital, and the operations of such section 8 companies, such companies are mandatorily required to make an application with the Depository (NSDL/CDSL) for obtaining an International Securities Identification Number (ISIN). If a company is incorporated under section 8 of the Companies Act (as a company Limited by Shares) and the said company is a private company, then it may make an application to the NCLT having jurisdiction under section 230 read with section 18 and 66 of the Companies Act and Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 and seek similar relief. It would be necessary to also make an application under section 66 of the Companies Act as the company's share capital won't exist consequent to the conversion of the company into a Guarantee Company. The only distinguishing factor between the application in the present case of Azim Premji Trust Services Private Limited and the application of a section 8 company would be that Azim Premji Trust Services Private Limited was not a company incorporated under section 25 of the Companies Act, 1956/section 8 of the Companies Act, 2013. In any case, the said precedent is relevant. As professionals, we have to consider the time, cost, and allocation of resources for the conversion of a section 8 company from Company Limited by shares to Company Limited by Guarantee, vis-à-vis the initial and recurring costs of dematerialisation of shares of the said section 8 company.

