2019 INSC 597

REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 4476 OF 2019
(Arising out of Special Leave Petition (Civil) No. 4210 of 2018)

63 MOONS TECHNOLOGIES LTD.
(FORMERLY KNOWN AS FINANCIAL
TECHNOLOGIES INDIA LTD.) & ORS. … APPELLANT

VERSUS

UNION OF INDIA & ORS. … RESPONDENT

WITH
CIVIL APPEAL NO. 4478 OF 2019
(Arising out of Special Leave Petition (Civil) No.4652 of 2018)

WITH
CIVIL APPEAL NO. 4477 OF 2019
(Arising out of Special Leave Petition (Civil) No.4239 of 2018)

WITH
CIVIL APPEAL NO. 4479 OF 2019
(Arising out of Special Leave Petition (Civil) No.4659 of 2018)

WITH
CIVIL APPEAL NO. 4481 OF 2019
(Arising out of Special Leave Petition (Civil) No.4816 of 2018)

WITH
CIVIL APPEAL NO. 4480 OF 2019
(Arising out of Special Leave Petition (Civil) No. 4720 of 2018)

WITH
WRIT PETITION (CIVIL) NO.368 OF 2019

JUDGMENT

R.F. NARIMAN, J.

1. Leave granted.

2. This batch of appeals and writ petition raises questions as to the applicability and construction of Section 396 of the Companies Act, 1956, which deals with compulsory amalgamation of companies by a Central Government order when this becomes essential in the public interest. The appellant, 63 Moons Technologies Ltd. (hereinafter referred to as "**FTIL**", which name was changed to 63 Moons Technologies Ltd. on 27.05.2016), is a 99.99% shareholder of the National Spot Exchange Ltd. (hereinafter referred to as "**NSEL**"), and is a listed company. About 45% of the shareholding of FTIL is held by Shri Jignesh Shah and family, and about 43% of the shareholding is held by members of the Indian public. Approximately 5% of the shareholding is held by institutional investors. FTIL is a profitable company, having a positive net worth of over INR 2500 crore, and is in the business of providing software which is used for trading by brokers and exchanges across the country. FTIL has about 900 employees, and a Board of Directors which is different from the Board of Directors of its wholly owned subsidiary, i.e., NSEL. On the other hand, NSEL

was incorporated in 2005 by Multi Commodities Exchanges ["**MCX**"] and its nominees. NSEL provided an electronic platform for trading of commodities between willing buyers and sellers through brokers representing them. On 05.06.2007, the Union of India issued an exemption notification under Section 27 of the Forward Contracts (Regulation) Act, 1952 ["**FCRA**"] exempting forward contracts of one-day duration for sale and purchase of commodities traded on NSEL from operation of the provisions of the FCRA. NSEL commenced operations in October 2008. On 27.04.2012, the Department of Consumer Affairs ["**DCA**"] issued a show cause notice to NSEL as to why action should not be initiated against it for permitting transactions in alleged violation of the exemption granted to it under the FCRA. NSEL replied to the show cause notice on 29.05.2012 stating that it had not violated the exemption granted to it. Without adjudicating upon the show cause notice, on 12.07.2013, the DCA directed NSEL to give an undertaking that no further contracts shall be launched until further instructions, and that all existing contracts will be settled on due dates. This was effectively a "freezing" order. On 22.07.2013, NSEL gave an undertaking to the DCA.

3. Earlier, in January 2013, representatives of MMTC Ltd., a Government of India undertaking, which was one of the trading

members of NSEL, visited some of the warehouses which were at different locations in order to verify stocks therein and reported existence of full commodity stock in the said warehouses. Sometime in July 2013, 13,000 persons who traded on the platform of NSEL claimed to have been duped by other trading members (being 24 in number), who defaulted in payment of obligations amounting to approximately INR 5600 crore. Due to the sudden and abrupt stoppage of fresh contracts, and media reports about the same, market participation on NSEL's platform reduced considerably, forcing NSEL to suspend trading and close its spot exchange operations w.e.f. 31.07.2013. The Forward Markets Commission ["**FMC**"] recommended to the DCA on 12.08.2013 that steps be taken to verify quantity and quality of commodities at various warehouses; financial status of buyers and trading members be ascertained, and the liability be fixed on promoters of NSEL, i.e., FTIL. On 14.08.2013, NSEL issued a press release in which Shri Sinha, its CEO/MD, made a statement that he and his management team were responsible for all operations at NSEL. On 27.08.2013, the FMC directed a forensic audit of NSEL by Grant Thornton LLP, and the Union of India, on 30.09.2013, ordered inspection of the books of accounts of NSEL and FTIL under Section 209A of the Companies Act. On the same day, the Economic Offences

Wing ["**EOW**"] registered cases against Directors and key management personnel of the NSEL and FTIL, trading members of NSEL, and brokers of NSEL under various provisions of the Indian Penal Code and the Maharashtra Protection of Interest of Depositors Act, 1999 ["**MPID Act**"]. Several suits were filed by the traders who allegedly have been duped, the most important of which is Suit No.173 of 2014 pending in the Bombay High Court, which is a representative suit filed under Order I Rule 8 of the Code of Civil Procedure, 1908 ["**CPC**"]. NSEL also filed third-party notices in the said suit for recovery of INR 5600 crore against 24 defaulter traders. It has also filed various arbitration proceedings against them, and is in the process of recovery of INR 3365 crore out of INR 5600 crore, which are in the form of court decrees and arbitration awards.

4. On 17.12.2013, based on the Grant Thornton report dated 21.09.2013, the FMC passed an order declaring that FTIL was not "fit and proper" to hold equity in any commodity exchanges, and must dilute its shareholding to not more than 2% of the paid-up equity capital of MCX. The said order is under challenge in Writ Petition No. 337 of 2014 before the Bombay High Court. On 28.02.2014, the Division Bench of the Bombay High Court refused a prayer for stay of the aforesaid order, stating that findings of fact of a serious nature

have been recorded against the appellant, and the fraud perpetrated is to the tune of INR 5500 crore.

5. On 06.01.2014, the Economic Offences Wing, Mumbai, filed chargesheets against the Managing Director and CEO of NSEL, Shri Sinha, the Head of Warehousing of NSEL, Shri Babu Kanvi, and two other defaulters. In the chargesheet, it was revealed that the aforesaid three employees of NSEL, in exchange for monetary kickbacks, had colluded with the defaulters to enable them to trade on NSEL's platform without depositing adequate goods in the warehouses, in breach of rules and byelaws of NSEL.

6. On 18.08.2014, the FMC, *vide* a letter to the Union of India, suggested that FTIL and NSEL be merged. Meanwhile, in the representative Suit No. 173 of 2014, *vide* order dated 02.09.2014, the Bombay High Court appointed a three-member committee consisting of Mr. Justice V.C. Daga, Mr. J. Solomon, and Mr. Yogesh Thar for ascertaining and crystallising the liability of the defaulters and to assist in recovery of debts from the defaulters. This committee continues to function even on date. Thus, in addition to INR 3365 crore, i.e., the total of decrees and arbitration awards against the defaulters, this high-level committee has also crystallised a further sum of INR 835.88

crore to be recovered from the defaulters, which is pending before the Bombay High Court.

7. On 19.09.2014, the Ministry of Finance, Government of India, issued a notification withdrawing the exemption granted to NSEL *vide* notification dated 05.06.2007. Exemptions granted to the National Commodity and Derivatives Exchange Ltd. (NCDEX) Spot Exchange and the National Agricultural Produce Market Committee (APMC) were also withdrawn as the Government was of the view that ready delivery or spot delivery contracts in commodities ought not to be traded on commodities exchanges at all. On 15.10.2014, Dr. K.P Krishnan, Additional Secretary, Department of Economic Affairs, wrote a letter to the Ministry of Corporate Affairs stating that FTIL and NSEL appear to be maintaining separate identities for a fraudulent purpose, i.e., to deprive investors of their money. As a result, there is a need to lift the corporate veil in order to unearth the fraud, as a result of which, amalgamation of two companies, where one has defrauded market participants and the other company is cash-rich and capable of addressing the payment crisis more effectively. It was therefore proposed to merge FTIL and NSEL under Section 396 of the Companies Act. On 21.10.2014, a draft order of amalgamation, made in accordance with Section 396(3) of the Companies Act, was

circulated to the relevant stakeholders. As a result, FTIL filed Writ Petition No. 2743 of 2014 on 10.11.2014, in which it challenged the impugned draft order. On 27.11.2014, the Bombay High Court directed the parties to maintain status quo. On 16.12.2014, the Union of India filed an affidavit in reply, categorically confirming that the impugned draft order has been made by the Central Government on the basis of the FMC's proposal dated 18.08.2014. On 04.02.2015, the Bombay High Court vacated the status quo order, and passed an order allowing FTIL, NSEL, and their shareholders to file their objections to the draft amalgamation order. Meanwhile, under Section 396(3), a compensation order was made on 01.04.2015, which involved compensation only to a particular shareholder of NSEL. On 28.08.2015, the Central Government issued a notification to merge the functions of the FMC with the Securities and Exchange Board of India ["**SEBI**"] w.e.f. 28.09.2015. On the same day, the FCRA was also repealed. Thus, SEBI was now vested with the powers of the FMC which is to be governed by the Securities and Exchange Board of India Act, 1992 ["**SEBI Act**"].

8. FTIL and NSEL were granted a hearing on their objections to the impugned draft amalgamation order by a committee consisting of Shri Pritam Singh, Additional Secretary to the Government of India, and

Shri H.P. Chaturvedi, Joint Secretary and Legal Advisor, Ministry of Law and Justice in October 2015, pursuant to a Bombay High Court order in the Writ Petition 2743 of 2014 pending before it.

9. On 12.02.2016, a final amalgamation order was passed in terms of Section 396(3), thereby merging FTIL and NSEL, wherein all assets and liabilities of NSEL would become assets and liabilities of FTIL. The writ petition already filed was amended on 28.03.2016 to include a challenge to this order. On 04.12.2017, the impugned judgment of the Bombay High Court was passed in which the said writ petition was dismissed.

10. We have heard Shri Mukul Rohatgi, Shri Vikas Singh, Dr. A.M. Singhvi, and Shri Kavin Gulati, learned Senior Advocates, and Shri Arvind Lakhawat, learned Advocate, on behalf of the appellants. According to learned counsel, the first important point to be noted is that in company law, the holding company, *viz*. FTIL, is distinct and separate from its subsidiary, *viz*., NSEL. It was pointed out to us that there are separate and independent Boards of Directors for managing the day-to-day affairs of both companies, which deal in completely different businesses. It was pointed out that FTIL has never participated in the profits of NSEL, and except for receiving annual

maintenance charges for providing technology-related services by way of fees, FTIL has not derived any revenue from NSEL. In fact, over a long period of nine years, FTIL has received only a sum of INR 84 crore from NSEL which, in any case, is deposited by FTIL in the Bombay High Court pursuant to an order dated 12.06.2015 in Writ Petition No. 2187 of 2015. Learned counsel were also at pains to point out that NSEL has not defrauded anybody since it is only a platform. Currently, the business of NSEL is closed, whereas, on the other hand, the business of FTIL is flourishing. A compulsory amalgamation order would be *ultra vires* Section 396 if the only object is to foist unadjudicated liability of NSEL on FTIL. It was also pointed out that the basis of the amalgamation order was a letter by the FMC, which in turn was based on a “forensic” audit report of 2013 by Grant Thornton. The so-called report itself stated that there is no independent verification of information provided, and consequently, would not constitute an audit, let alone a forensic audit. It also stated that should additional information become available, which impacts upon conclusions reached in the report, Grant Thornton reserved the right to amend their findings, which are not intended to be interpreted to be either legal advice or opinion; in short, that the findings themselves were inconclusive.

11. Learned counsel have argued that the impugned order is *ultra vires* Section 396 for many reasons. First and foremost, the condition precedent to passing an amalgamation order is that compensation be assessed under Section 396(3) of the Act. Compensation has to be assessed *qua* both the transferor and transferee company. In the present case, compensation has been assessed only for NSEL or its shareholders, without any compensation being awarded to FTIL or its shareholders. Secondly, a member or creditor is required to be placed in the same position "as nearly as possible". In the present case, the amalgamated company would become a company of negative net worth upon amalgamation, having had a positive net worth of almost INR 2800 crore pre-amalgamation. This being so, the very basis for application of Section 396 would disappear as the amalgamated company, i.e., the transferee company would have to pay the compensation that is assessed. This obviously cannot be done when the amalgamated company itself becomes a negative net worth company. It was then argued that the amalgamation order interfered with the judicial process in that decrees and arbitral awards obtained by NSEL against defaulters are wholly ignored. Further, the process of adjudication, which will determine whether there are defaults and whether they need to be paid back, has been short-circuited by

amalgamating NSEL with FTIL. Thus, the learned counsel have all argued that various conditions precedent for applicability of Section 396 are wholly absent. Also, in the present case, the Central Government has not applied its mind to whether such an order is, first of all, “essential”. Secondly, unadjudicated so-called liabilities to persons who are members of one particular exchange can hardly be said to be something which requires the Central Government to amalgamate both companies in the “public interest”. The public interest consists of the interests of the general public which would include, *inter alia*, the interest of the 63,000 shareholders of FTIL, who are now going to be mulcted with a huge liability which would reduce the market value of their shares to nil. They have cited several judgments to buttress these submissions.

12. Thus, the amalgamation order oversteps recognised separation of powers’ limits, and is therefore, *ultra vires* both Section 396 of the Companies Act and the Constitution of India. It was then argued that there are three grounds in support of the order of amalgamation, which are to be found in the impugned judgment, namely:

A. Restoring / safeguarding public confidence in forward contracts and exchanges which are an integral and essential part

of the Indian economy and financial system, by consolidating the businesses of NSEL and FTIL;

B. Giving effect to the business realities of the case by consolidating the businesses of FTIL and NSEL and preventing FTIL from distancing itself from NSEL, which is even otherwise its alter ego; and

C. Facilitating NSEL in recovering dues from the defaulters by pooling human and financial resources of FTIL and NSEL

Admittedly, reasons A and B are not in the draft order. This being so, obviously, no objections or suggestions could be made *qua* reasons A and B, as a result of which the final order would, therefore, be *ultra vires* Section 396(3) of the Companies Act.

13. All the stated objectives at page 1 of the amalgamation order itself – (a) to leverage combined assets, capital and reserves; (b) to achieve economy of scale; (c) efficient administration; (d) gainful settlement of rights and liabilities of stakeholders and creditors; (e) to consolidate businesses; and (f) to ensure coordination and policy – are totally vague and do not lead to any application of mind to such amalgamation order being essential in public interest. Article 31A of the Constitution of India was relied upon, and it was argued that

amalgamation under Article 31A(1)(c) of two or more corporations can only be made in public interest or in order to secure proper management of any of the corporations, which is wholly missing in the present case. It was also argued that only Shri Pritam Singh had signed the order which dismissed the objections, even though the objections were heard by a two-member committee. They also made submissions that even otherwise, the impugned order was violative of natural justice and of Articles 14, 19, and 300A of the Constitution of India. Also, since the amalgamation order is based upon an order of the FMC, which in turn is based upon the Grant Thornton report, which was delivered in a great hurry, and with such disclaimers that it could never be relied upon to render final findings, as has been done by the amalgamation order, the amalgamation order itself would be without application of mind, excessive and arbitrary, and violative of Article 14 of the Constitution of India on this score alone.

14. When it came to the impugned judgment, the learned counsel for the appellants were at pains to point out that when the impugned judgment held that no compensation need be paid to FTIL as the number of shares in the amalgamated company of shareholders remain the same, economic value or market value of the shares was totally ignored. Thus, in ignoring economic value, a totally artificial,

formal, and non-substantial test has been applied by the Bombay High Court, which says that there is no necessity to compensate the shareholders of FTIL, even though once they become members of the amalgamated company, their shares would be worth nil on the date of amalgamation. And, in the event of winding up, they would get back nothing. It was also pointed out that the three grounds of the amalgamation order, being reasons for the amalgamation order, which were accepted by the Bombay High Court, are grounds which do not exist. In ground A, for example, restoring / safeguarding public confidence in forward contracts and exchanges which are an integral and essential part of the Indian economy, does not obtain as there were only three commodity exchanges in the country, all of which were shut down w.e.f. September 2014. No similar exchanges have been created subsequently. In any case, the business done at such exchanges cannot be said to be an integral and essential part of the Indian economy. Reason B, which is that NSEL is an alter ego of FTIL, is pending adjudication in the suits filed in the Bombay High Court. To come to a conclusion that one is the alter ego of the other is not only contrary to the facts pointed out hereinabove, namely, that the businesses of the two companies are entirely different and the management of both companies is by completely different and distinct

Boards of Directors. Thus, to arrive at the conclusion that one company is the alter ego of the other, without adjudication, would itself be arbitrary and violative of Article 14 of the Constitution of India. The only reason which would remain, therefore, would be reason C, which is that the real object of the entire exercise to recover alleged dues from alleged defaulters pre-adjudication and pending adjudication, which would be looking at the problem in a wholly one-sided way, and would be an excessive invasion of the rights of the shareholders and creditors of FTIL, all of whom have overwhelmingly voted against amalgamation. In fact, it is pointed out that there is no question of "public interest" and Section 396 is actually used in order to penalise "Ram", namely, NSEL and FTIL, for the default of "Shyam", namely, the 24 alleged defaulters, when not even a single default or any civil or criminal wrong can be attributed either to FTIL or to NSEL. The impugned order would therefore also fail on the ground of proportionality, which is a facet of Article 14. For all these reasons, in addition, the impugned order ought to be struck down as *ultra vires* Article 31A of the Constitution of India and Section 396 of the Companies Act, and be declared to be violative of Article 14, Article 19 and Article 300A of the Constitution of India.

15. Shri Shyam Divan, learned Senior Advocate appearing on behalf of Respondent No. 4, NSEL Investors Action Group, supported the impugned judgment in its entirety. According to the learned Senior Advocate, it must never be forgotten that FTIL held 99.9998% of NSEL's shares, and that NSEL was promoted by and is part of the FTIL group. The Board of Directors of NSEL is entirely under the control of FTIL. NSEL's exchange was treated, held out, and represented by FTIL to be its own, and was part of its "exchange verticals". Shri Jignesh Shah is the common linchpin of both the companies. He holds 45% shares of FTIL and is its Chairman-cum-Managing Director. He is also Vice Chairman on the Board of NSEL, being one of the "key managerial personnel" of the aforesaid company. He also was a member of the Audit Committee of NSEL. All the minutes of the Board meetings of NSEL were regularly tabled at the Board meetings of FTIL, showing therefore, that FTIL has full knowledge of the goings-on in NSEL. NSEL's outward emails were routed through an outbox called "FT outbox" through which all emails of all FTIL-group companies were routed. What is clear, therefore, is that on a reading of the Grant Thornton report, NSEL has, at least from 2009, promoted what are called "paired contracts" in commodities which were, in fact, financing transactions, which were totally distinct

from sale and purchase transactions in commodities. In fact, by April to July, 2013, 99% of the turnover of NSEL was made up of such paired contracts. This mechanism was in breach of the conditions of exemption granted to NSEL dated 05.06.2007, and in breach of the provisions of the FCRA. Contrary to what was actually going on in NSEL, NSEL kept inducing persons to come to its platform by reiterating that they deal only with commodities and spot delivery of the same. It is only in 2012 that the FMC, being apprised of the real activities of NSEL, wrote to the DCA, indicating that its business was in complete breach of the FCRA. What is extremely important is that Shri Jignesh Shah made representations to the DCA and the FMC on 10.07.2013, in which he stated that NSEL had full stock of commodities as collateral and had 10-20% of open position as margin money. He also stated that the stock currently held in NSEL's 120 warehouses was valued at around INR 6000 crore. It is in July, 2013 that the payment crisis of INR 5600 crore arose on NSEL, FTIL admitting that this was the result of a fraud. On 14.08.2013, NSEL wrote to the FMC, setting out a detailed settlement plan. The plan indicated the period within which the entire dues would be paid, with simple interest at 8% to 16% per annum. This plan was an abject failure. As a result, a forensic audit was conducted by Grant Thornton,

which in its report dated 21.09.2013, came out with damning facts and figures as to the real operations of NSEL, namely, that they are not a commodity exchange, but a finance exchange, and that no commodities were really in stock. As a result, the FMC issued show cause notices and then passed its order dated 17.12.2013 based on the aforesaid report, in which it found NSEL guilty of severe malpractice. Based on this order, the draft order and final order of amalgamation were then made. Shri Divan was at pains to point out that as early as on 18.08.2014, the FMC had written a detailed letter to the Secretary, Ministry of Corporate Affairs, in which it indicated that as NSEL was financially incapable of repaying all those investors/traders who allegedly got duped, it would be expedient in public interest to amalgamate NSEL with its parent, FTIL, so that its parent's resources could be used to repay these debts. He then argued that the reason for the amalgamation order was not merely the repayment of debts of the allegedly duped investors/traders, but to instil confidence in commodity markets, for it is only when their debts are immediately paid would persons come forward to platforms like NSEL to trade in commodities. According to the learned Senior Advocate, there was no breach of natural justice in passing the final amalgamation order as FTIL and NSEL were both heard pursuant to a Bombay High Court

order, even though Section 396 of the Companies Act does not require any hearing. He also argued that the order of amalgamation is of the nature of delegated legislation and is not an administrative order, as a result of which, the immunity granted by Article 31A to “all laws” dealing with such amalgamation from challenge on the ground of Articles 14 and 19 would come into full play. This being so, none of the grounds taken up by the appellants could be gone into as they all pertained to infractions of Articles 14 and 19 of the Constitution of India. According to the learned Senior Advocate, the order was passed after being satisfied on the objective facts set out hereinabove that it was essential in public interest to pass such order and could not, therefore, be held to be ultra vires. He also supported the judgment of the High Court when it stated that the economic value of shares of FTIL is not the subject matter of Section 396, and that, therefore, it was not necessary to provide FTIL’s shareholders any compensation under Section 396(3).

16. Shri Rakesh Dwivedi, learned Senior Advocate also appearing on behalf of Respondent No.4, supplemented the submissions of Shri Divan. According to him, nowhere does the Central Government order direct any payment to be made by the amalgamated company. The amalgamation is only so that the finances of FTIL can be used to

pursue on-going litigation as NSEL does not have the wherewithal to do so. Thus, it is wholly incorrect for the appellants to say that FTIL will become mulcted with the liabilities of NSEL, as a result of which the shareholders of FTIL will suffer. He added that the overwhelming majority of shares in FTIL are owned by Shri Jignesh Shah and his family (45%) and by Shri Ravi Sheth and Shri Bharat Sheth (8%). Thus, the majority shares held in FTIL are by two masterminds of the scam. That apart, after the scam, 24% of the shares have been purchased by speculators, taking advantage of the low price at which such shares were offered. Such persons, therefore, are purely speculative investors who do not need to be compensated under Section 396 of the Act. Also, the economic value of shares, if at all it is to be taken into account, is an uncertain and fluctuating phenomenon. As examples, he stated that the book value of a share of FTIL, after the scam broke out, was only INR 2/-, whereas the listed value actually went up after the FMC order of 17.12.2013. All this, therefore, is dependent on market forces, and share price varies according to market forces and not as a result of any amalgamation that is effected. He also added that it is incorrect to state that one of the conditions precedent for applicability of Section 396 was absent. Even if a compensation order was made awarding nil compensation to

shareholders and creditors of FTIL, they could have appealed against the same. Not having done so, it cannot be said that the Central Government order was passed without adhering to the provisions of Section 396(3) and (4) of the Act. When it came to the three grounds of public interest stated by the High Court, the learned Senior Advocate argued that grounds (a) and (b) are only inferences to be drawn from facts which are all stated in the order, and therefore, need not have been in the draft order. There is thus no infirmity or breach of principles of natural justice as provided in Section 396(3) and (4). He was at pains to analyse Article 31A, and stated that the expression "public interest" contained in Article 31A will have to be construed broadly. Equally, the word "essential" in Section 396 is essentiality according to the Central Government, and thus, very wide latitude needs to be extended to the Government when it exercises its discretion, stating that it is essential in public interest to amalgamate two companies. He laid great emphasis on the judgment in **Ganesh Bank of Kurundwad Ltd. v. Union of India**, (2006) 10 SCC 645 ["**Ganesh Bank**"], stressing that amalgamations that are made under Section 45 of the Banking Regulation Act, like amalgamations made under Section 396, can be made so that a weak entity merge with a strong entity in the interest of the depositors of the weak entity. He also

cited various judgments to show that stock exchanges are intimately linked with the economy of the country, and therefore, if anything goes wrong with them, there is a direct link with public interest. He emphasized the fact that in Section 396(3), the shareholders of FTIL only need to be compensated "as nearly as may be" and that mathematical precision is not necessary. He then distinguished the judgment in **Mohinder Singh Gill v. Chief Election Commissioner**, (1978) 1 SCC 405 ["**Mohinder Singh Gill**"], cited by the appellants, stating that where larger public interest is involved, the ratio of that judgment will not apply. He cited two judgments in support of this proposition. He also went on to cite certain judgments which distinguished **K.I. Shephard v. Union of India**, (1987) 4 SCC 431 ["**K.I. Shephard**"], and therefore, argued that the Central Government order passed under Section 396 is really in the nature of delegated legislation and need not conform to any natural justice outside what is provided for in the Section itself. He then cited certain judgments on lifting of the corporate veil, and ended by saying that as was held in **J.K. (Bombay) (P) Ltd. v. New Kaiser-i-Hind Spinning and Weaving Co. Ltd.**, [1969] 2 SCR 866 ["**J.K. (Bombay) (P) Ltd.**"], the Central Government order would have statutory force, and therefore, cannot be said to be a mere administrative order.

17. Shri Arvind Datar, learned Senior Advocate appearing on behalf of SEBI, fully supported the impugned judgment and took us through various portions of it. He was at pains to point out that the Grant Thornton report was a report of a forensic auditor chosen by NSEL itself, though required to do so by the FMC. He took us through the FMC order dated 17.12.2013 meticulously, and said that none of the findings therein could be assailed by either FTIL or NSEL. He then referred to the Central Government order and supported the High Court judgment's upholding of it. He then relied upon the Director's Report of NSEL dated 20.07.2015, and balance sheet as on 31.03.2015 to show that no potential liability of INR 5600 crore is at all referred to in the Director's Report or in the balance sheet. He was at pains to point out, therefore, that NSEL itself was an exchange which made it clear that it would not be responsible for any liabilities incurred by its members except to the extent of the SG fund created out of the members' contribution. He then argued that given the magnitude of the scam that broke out in July 2013, the Government had to act. It could have chosen one of many ways in which to act, but since it had *bona fide* chosen the amalgamation route provided by Section 396 of the Companies Act, it is obvious that in dealing with a scam of this magnitude, the Government has acted in public interest.

18. Ms. Pinky Anand, learned Additional Solicitor General appearing on behalf of the Union of India, meticulously took us through a long list of dates and events which showed that NSEL had flouted the conditions of its exemption order and had never really carried out ready delivery or spot delivery contracts in goods. Indeed, according to her, NSEL never had a single registered warehouse in its name as the Warehousing Development and Regulatory Authority had rejected NSEL's application for registration of its warehouses as far back as on 16.05.2011. Therefore, NSEL stating that it had 120 warehouses owned by itself was a misrepresentation made to the public from the very beginning. It is also clear, that when the scam broke out, Grant Thornton, as forensic auditor, went into the affairs of NSEL and came out with a number of key findings, which she referred to and took us through portions of the Grant Thornton report. The FMC order dated 17.12.2013 was also referred to and relied upon by her. She also referred to the fact that the exemption order dated 05.06.2007 granted to NSEL was withdrawn on 19.09.2014 as commodities markets which were supposed to be markets where spot delivery of goods took place, had never in fact taken place and therefore, exemption granted to all spot exchanges dealing in commodities, including two other spot exchanges that existed, were withdrawn. However, the Bombay Stock

Exchange Ltd. (BSE), the National Stock Exchange of India Ltd. (NSE), and MCX continued with commodity trading, but not on a spot basis. She also referred us to a subsequent event, that is an event subsequent even to the impugned judgment, namely, to a serious fraud investigation report dated 31.08.2018 which, according to her, corroborated all the findings made by Grant Thornton, the FMC, and the Central Government by its final order. She then argued that Section 396 of the Companies Act is a special, self-contained, standalone code by itself and must be read as such, and that all procedural aspects of Section 396 have been complied with on the facts of the present case. The satisfaction of the Central Government that it is essential in public interest to act under Section 396 is purely subjective satisfaction. She referred to and relied upon **Bacha F. Guzdar v. Commissioner of Income Tax**, [1955] 1 SCR 876 [“**Bacha F. Guzdar**”], to support the reasoning of the High Court on the compensation order. She also referred to and relied upon the share market prices to show that market fluctuations took place on their own, and that share prices plummeted only as a result of the scam which came to light in July, 2013. She also stated that since neither FTIL nor its shareholders and creditors filed any appeal against the compensation order, they waived their right to do so. She then

supported the final amalgamation order and stated that it was manifest that it was made in “public interest”. For this, she relied upon a number of judgments to support her contention that “public interest” has to be given a broad connotation. She also countered the submission of Shri Rohatgi that of the two persons who heard the objections, only one person signed, and therefore, their report would be non-est. She stated that this technical objection cannot stand in the way of the final government order which took into account all objections and suggestions made, and answered all of them. She also referred to the role of stock markets in the national economy and stated that to prop up stock and commodities exchanges is certainly in public interest. The three distinct grounds on public interest, found by the High Court, are more than sufficient to sustain the impugned Central Government order. Finally, in her last written argument, she relied upon two judgments of this Court, namely, **Union of India v. G. Ganayutham**, (1997) 7 SCC 463 and **Om Kumar v. Union of India**, (2001) 2 SCC 386, stating the current position of the doctrine of proportionality in administrative law.

19. Shri Tushar Mehta, learned Solicitor General for India, who also appeared on behalf of the Union of India, re-emphasised the facts which led to the final amalgamation order. According to him, the

impugned order dated 12.02.2016 is based on public interest as it reflects the Government's reaction to a large scam which broke in the year 2013, and which effected the commodities market generally. He dwelt at some length on subjective satisfaction and judicial review, and referred to **Barium Chemicals Ltd. v. Company Law Board**, [1966] Supp SCR 311 ["**Barium Chemicals**"], **Rohtas Industries Ltd. v. S.D. Agarwal**, [1969] 3 SCR 108 ["**Rohtas Industries**"], and other judgments to emphasise that it was not for the Court to sit in judgment over the sufficiency of the reasons for which the Central Government passed its order in public interest. He also stated that the right to choose between different courses of action is a right inherent in a responsive government, and it is only when such choice is so unfair or unreasonable that no reasonable person would have taken such action, that the Court can intervene. For this purpose, he cited **Haryana Financial Corporation v. Jagdamba Oil Mills**, (2002) 3 SCC 496. According to him, essentiality is not reviewable except by the Wednesbury test, and the Court should ask itself the question as to whether no reasonable person could have concluded that the impugned order was essential in the public interest. He reiterated that the order dated 12.02.2016 is not *ultra vires* Section 396 as several findings which show that amalgamation is essential in public interest

has been arrived at on the basis of undisputed facts, and that therefore, the said order should be upheld. He also argued that such order, if passed, is in the nature of delegated legislation, and therefore, does not have to satisfy any rules of natural justice outside what is prescribed by Section 396 itself which, according to him, has been procedurally and substantively complied with, as reflected in the order dated 12.02.2016.

20. Shri Neeraj Kishan Kaul, learned Senior Advocate, also appearing on behalf of some of the alleged duped investors/traders, referred to the Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999, and stated that the persons who had invested monies in the commodities exchange of NSEL have been held to be “depositors” by a judgment dated 01.10.2015 of the High Court of Bombay, from which an SLP has been dismissed by this Court. He also brought to our notice another judgment dated 01.11.2018, also of the Bombay High Court, in which NSEL and FTIL had breached an injunction order, and had to apologise and pay back monies in order to avoid being held guilty of contempt of court. He also stressed that “economic value” of shares is a stranger to Section 396(3) of the Companies Act. He then relied upon two reports of the RBI, both of which say that the modern trend in corporate law

worldwide is that if losses are borne by a corporation, it is the shareholders who should bear the brunt.

21. Having heard learned counsel for all the parties, it is necessary at this juncture to first set out Article 31A of the Constitution of India, which states:

> "**31A. Saving of laws providing for acquisition of estates, etc**.—(1) Notwithstanding anything contained in Article 13, no law providing for—
>
> xxx xxx xxx
>
> (*c*) the amalgamation of two or more corporations either in the public interest or in order to secure the proper management of any of the corporations, or
>
> xxx xxx xxx
>
> shall be deemed to be void on the ground that it is inconsistent with, or takes away or abridges any of the rights conferred by article 14 or article 19.
>
> xxx xxx xxx"

"Law" has been defined in Article 13(3) as follows:

> "**13. Laws inconsistent with or in derogation of the fundamental rights**.—
>
> xxx xxx xxx
>
> (3) In this article, unless the context otherwise requires, —
>
> (*a*) "law" includes any Ordinance, order, bye-law, rule, regulation, notification, custom or usage having in the territory of India the force of law;

xxx xxx xxx”

It will thus be seen that any “law” providing for the amalgamation of two or more corporations in public interest is immune from challenge on grounds relatable to Article 14 or Article 19 of the Constitution of India. It is not disputed that Section 396 of the Companies Act is such a law.

22. Section 396 of the Companies Act, 1956, reads as under:

> “**396. Power of Central Government to provide for amalgamation of companies in public interest**.—(1) Where the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, then, notwithstanding anything contained in Sections 394 and 395 but subject to the provisions of this section, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution; with such property, powers, rights, interests, authorities and privileges; and with such liabilities, duties, and obligations; as may be specified in the order.
>
> (2) The order aforesaid may provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and may also contain such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.
>
> (3) Every member or creditor (including a debenture holder) of each of the companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the company resulting from the amalgamation as he had in the company of which he was originally a member or creditor; and to the

extent to which the interest or rights of such member or creditor in or against the company resulting from the amalgamation are less than his interest in or rights against the original company, he shall be entitled to compensation which shall be assessed by such authority as may be prescribed and every such assessment shall be published in the Official Gazette.

The compensation so assessed shall be paid to the member or creditor concerned by the company resulting from the amalgamation.

(3A) Any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal.

(4) No order shall be made under this section, unless:

(*a*) a copy of the proposed order has been sent in draft to each of the companies concerned;

(*aa*) the time for preferring an appeal under sub-section (3A) has expired, or where any such appeal has been preferred, the appeal has been finally disposed of; and

(*b*) the Central Government has considered, and made such modifications, if any, in the draft order as may seem to it desirable in the light of any suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof.

(5) Copies of every order made under this section shall, as soon as may be after it has been made, be laid before both Houses of Parliament."

It will be seen that Section 396 provides for compulsory amalgamation of companies in public interest. The said Section occurs in Chapter V of the Companies Act which reads, “arbitrations, compromises, arrangements and reconstructions”. Sections 391 to 394 deal with voluntary compromises and arrangements, including amalgamation of two or more companies. By way of contrast, Section 396 deals with compulsory amalgamation of companies.

INTERPRETATION OF SECTION 396

23. There is no doubt whatsoever that Section 396 cannot be challenged on the ground of Article 14 or Article 19, given Article 31A of the Constitution of India. However, this does not mean that Section 396 must be construed in such a fashion that it would lead to arbitrary or unreasonable results. In **Prem Nath Raina v. State of Jammu & Kashmir and Ors.**, (1983) 4 SCC 616, this Court, in dealing with a challenge to the J&K Agrarian Reforms Act, 1976, which was protected by Article 31A, held:

> “**9.** ……The exclusion of a constitutional challenge under Articles 14, 19 and 31 which is provided for by Article 31A does not justify in equity the irrational violation of these articles. This Court did observe in *Waman Rao* [*Waman Rao* v. *Union of India*, (1981) 2 SCC 362 : AIR 1981 SC 271 : (1981) 2 SCR 1] that: “It may happen that while existing inequalities are being removed, new inequalities may arise marginally and incidentally” but

> the legislature has to take care to see that even marginal and incidental inequalities are not created without rhyme or reason. The Government of J&K would do well to give fresh consideration to the provisions contained in Section 7(2) and modify the provisions regarding residence in order that they may accord with reason and commonsense. Article 31A does not frown upon reason and commonsense."

Equally, in **Budhan Singh and Anr. v. Nabi Bux and Anr.**, [1970] 2 SCR 10, this Court, while construing Section 90 of the U.P. Zamindari Abolition and Land Reforms Act, 1950, held:

> "Before considering the meaning of the word "held" in Section 9, it is necessary to mention that it is proper to assume that the law-makers who are the representatives of the people enact laws which the society considers as honest, fair and equitable. The object of every legislation is to advance public welfare. In other words as observed by Crawford in his book on Statutory Constructions that the entire legislative process is influenced by considerations of justice and reason. Justice and reason constitute the great general legislative intent in every piece of legislation. Consequently where the suggested construction operates harshly, ridiculously or in any other manner contrary to prevailing conceptions of justice and reason, in most instances, it would seem that the apparent or suggested meaning of the statute, was not the one intended by the law-makers. In the absence of some other indication that the harsh or ridiculous effect was actually intended by the legislature, there is little reason to believe that it represents the legislative intent."
>
> (at pp. 15-16)

DERIVATIVE IMMUNITY OF THE CENTRAL GOVERNMENT ORDER

24. The next question is whether the Central Government's order made under Section 396 would also receive the protective umbrella of Article 31A, given the fact that Section 396 is undoubtedly protected by Article 31A.

25. A similar question was raised and considered with respect to an order passed under the Essential Commodities Act, 1955. In **Prag Ice & Oil Mills v. Union of India**, (1978) 3 SCC 459 ["**Prag Ice & Oil Mills**"], by a majority judgment, it was held that the Mustard Oil (Price Control) Order, 1977, passed under Section 3 of the Essential Commodities Act, 1955 did not receive the immunity of Article 31B. This Court held:

> "**46.** Article 31A of the Constitution saves laws which provide for matters mentioned in clauses (*a*) to (*e*) thereof from a challenge under Articles 14, 19 or 31 notwithstanding anything contained in Article 13 of the Constitution. Article 31B which was introduced by the Constitution (First Amendment) Act, 1951, validates certain Acts and Regulations by providing that without prejudice to the generality of the provisions contained in Article 31A, "none of the Acts and Regulations specified in the Ninth Schedule nor any of the provisions thereof" shall be deemed to be void, or ever to have become void, on the ground that such Act, Regulation or provision is inconsistent with, or takes away or abridges any of the rights conferred by, any provisions of Part III. On a plain reading of this article it seems to us impossible to accept that the protective umbrella of the Ninth Schedule takes in its everwidening wings not only the Acts and Regulations specified therein but also Orders and Notifications issued under those Acts and

> Regulations. Article 31B constitutes a grave encroachment on fundamental rights and doubtless as it may seem that it is inspired by a radiant social philosophy, it must be construed as strictly as one may, for the simple reason that the guarantee of fundamental rights cannot be permitted to be diluted by implications and inferences. An express provision of the Constitution which prescribes the extent to which a challenge to the constitutionality of a law is excluded, must be construed as demarcating the farthest limit of exclusion. Considering the nature of the subject-matter which Article 31B deals with, there is, in our opinion, no justification for contending by judicial interpretation the provisions of the field which is declared by that article to be immune from challenge on the ground of violation or abridgement of fundamental rights. The article affords protection to Acts and Regulations *specified* in the Ninth Schedule. Therefore, whenever a challenge to the constitutionality of a provision of law on the ground that it violates any of the fundamental rights conferred by Part III is sought to be repelled by the State on the plea that the law is placed in the Ninth Schedule, the narrow question to which one must address oneself is whether the impugned law is specified in that Schedule. If it is, the provisions of Article 31B would be attracted and the challenge would fail without any further inquiry. On the other hand, if the law is not specified in the Ninth Schedule, the validity of the challenge has to be examined in order to determine whether the provisions thereof invade in any manner any of the fundamental rights conferred by Part III. It is thus no answer to say that though the particular law, as for example a Control Order, is not specified in the Ninth Schedule, the parent Act under which the Order is issued is specified in that Schedule."

26. In the present case, this judgment has no direct application except to say that Article 31A also constitutes a grave encroachment on fundamental rights, and must be construed strictly. The expression

used in Article 31A is “law”, for which, one is to see the definition contained in Article 13(3). “Law” in Article 13(3) certainly includes “order”. The only question is whether this would include an administrative order as well.

27. It is clear, on a reading of Article 13(3), that the expression “law”, as defined in Article 13(3)(a), includes an Ordinance, rule, regulation, notification, and custom or usage having in the territory of India the force of law. Obviously, therefore, when the expression “order” is used, it would take colour from Ordinance, rule, regulation, notification, which are all legislative in nature, and not administrative. Even custom or usage having the force of law refers to general rules of conduct, as opposed to administrative orders passed on the facts of a given case. Construing Article 31A in the light of Article 13(3)(a), it is clear that the “order” referred to, can therefore, only be a legislative order. Examples of legislative orders are of the kind dealt with in **Prag Ice & Oil Mills** (supra) and **Union of India and Anr. v. Cynamide India Ltd. and Anr.**, (1987) 2 SCC 720 [“**Cynamide India**”], namely, orders passed under statutes which are in the nature of subordinate legislation, which deal generally with a whole class of persons who are governed by the same in which general rules of conduct are laid down.

WHETHER THE CENTRAL GOVERNMENT ORDER IS ADMINISTRATIVE IN NATURE

28. This brings us to what is the nature of the order of the Central Government that is passed under Section 396. It has been argued on behalf of the Union of India, relying upon a number of judgments, that the nature of the order passed under Section 396 is that of delegated legislation. This being the case, it would, therefore, get immunity from challenge on the ground of Articles 14 and 19 of the Constitution of India, as it would then amount to a "law" within the meaning of Article 31A read with Article 13(3)(b).

29. The difference between an order which is legislative in nature and that which is administrative in nature has been discussed in some of our judgments. Thus, in **Cynamide India** (supra), this Court drew a distinction between administrative and legislative orders thus:

> "**7.** …… Any attempt to draw a distinct line between legislative and administrative functions, it has been said, is 'difficult in theory and impossible in practice'. Though difficult, it is necessary that the line must sometimes be drawn as different legal rights and consequences may ensue. The distinction between the two has usually been expressed as 'one between the general and the particular'. 'A legislative act is the creation and promulgation of a general rule of conduct without reference to particular cases; an administrative act is the

> making and issue of a specific direction or the application of a general rule to a particular case in accordance with the requirements of policy'. 'Legislation is the process of formulating a general rule of conduct without reference to particular cases and usually operating in future; administration is the process of performing particular acts, of issuing particular orders or of making decisions which apply general rules to particular cases.' It has also been said: 'Rule-making is normally directed toward the formulation of requirements having a general application to all members of a broadly identifiable class' while, 'an adjudication, on the other hand, applies to specific individuals or situations'. But, this is only a broad distinction, not necessarily always true. Administration and administrative adjudication may also be of general application and there may be legislation of particular application only. That is not ruled out. Again, adjudication determines past and present facts and declares rights and liabilities while legislation indicates the future course of action. Adjudication is determinative of the past and the present while legislation is indicative of the future……."

In **K.I. Shephard** (supra), this Court dealt with a scheme for amalgamation of three private banks with Punjab National Bank, Canara Bank, and State Bank of India, in terms of separate schemes drawn, merging each private bank with state banks under Section 45 of the Banking Regulation Act. It was urged that the order passed by the Reserve Bank of India amalgamating these banks was legislative in nature, as a result of which the principle of natural justice will not apply. In turning down this contention, this Court held:

> "**9.** …… Learned counsel for RBI and the transferee banks have taken the stand that the scheme-making

process under Section 45 is legislative in character and, therefore, outside the purview of the ambit of natural justice under the protective umbrella whereof the need to put the excluded employees to notice or enquiry arose. It is well settled that natural justice will not be employed in the exercise of legislative power and Mr Salve has rightly relied upon a recent decision of this Court being *Union of India* v. *Cynamide India Ltd.* [(1987) 2 SCC 720] in support of such a position. But is the scheme-making process legislative? Power has been conferred on the RBI in certain situations to take steps for applying to the Central Government for an order of moratorium and during the period of moratorium to propose either reconstruction or amalgamation of the banking company. A scheme for the purposes contemplated has to be framed by RBI and placed before the Central Government for sanction. Power has been vested in the Central Government in terms of what is ordinarily known as a Henry VIII clause for making orders for removal of difficulties. Section 45(11) requires that copies of the schemes as also such orders made by the Central Government are to be placed before both Houses of Parliament. We do not think this requirement makes the exercise in regard to schemes a legislative process. It is not necessary to go to any other authority as the very decision relied upon by Mr Salve in the case of *Cynamide India Ltd.* [(1987) 2 SCC 720] lays down the test. In para 7 of the judgment it has been indicated: (SCC pp. 735-36)

> "Any attempt to draw a distinct line between legislative and administrative functions, it has been said, is 'difficult in theory and impossible in practice'. Though difficult, it is necessary that the line must sometimes be drawn as different legal rights and consequences may ensue. The distinction between the two has usually been expressed as 'one between the general and the particular'. 'A legislative act is the creation and promulgation of a general rule of conduct without reference to particular cases; an administrative act is the making and issue of a

> specific direction or the application of a general rule to a particular case in accordance with the requirements of policy'. 'Legislation is the process of formulating a general rule of conduct without reference to particular cases and usually operating in future; administration is the process of performing particular acts, of issuing particular orders or of making decisions which apply general rules to particular cases.' It has also been said: 'Rule-making is normally directed towards the formulation of requirements having a general application to all members of a broadly identifiable class' while, 'an adjudication, on the other hand, applies to specific individuals or situations'. But, this is only a broad distinction, not necessarily always true."
>
> Applying these tests it is difficult to accept Mr Salve's contention that the framing of the scheme under Section 45 involves a legislative process. There are similar statutory provisions which require placing of material before the two Houses of Parliament yet not involving any legislative activity. The fact that orders made by the Central Government for removing difficulties as contemplated under sub-clause (10) are also to be placed before the two Houses of Parliament makes it abundantly clear that the placing of the scheme before the two Houses is not a relevant test for making the scheme-framing process legislative. We accordingly hold that there is no force in the contention of Mr Salve that the process being legislative, rules of natural justice were not applicable."

The fact that, under Section 396(5), the Central Government order has to be laid before the Houses of Parliament also does not detract from the fact that this order is administrative and not legislative in character. Applying these judgments to the Central Government's order passed

under Section 396, it is clear that the order directly impacts the rights and liabilities of the companies, their shareholders and creditors, sought to be amalgamated under the order. Such order is not an order in general which applies to all such companies, but only to the particular companies sought to be amalgamated. There is no general rule of conduct, without reference to the particular case that is laid down by such an order. The Central Government order, ultimately, makes a specific direction *qua* two specific companies which are to be amalgamated. It is clear that such an order is not in the nature of legislation or delegated legislation.

30. Learned counsel appearing on behalf of the respondents have cited **New Bank of India Employees' Union and Anr. v. Union of India and Ors.**, (1996) 8 SCC 407 ["**New Bank of India Employees' Union**"], which is a judgment which has distinguished **K.I. Shephard** (supra). This judgment was concerned with Section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 ["**Acquisition Act**"], which requires schemes that have been framed under the said Act to be laid before each House of Parliament for a total period of thirty days, in which, Parliament is then given the power to make any modification therein. Given the difference in language between the provisions, namely, Section 45 of the Banking Regulation

Act and Section 9 of the Acquisition Act, this Court distinguished the judgment of **K.I. Shephard** (supra) thus:

> "**32.** The only other question which remains for consideration is whether the conclusion of the High Court that the scheme-making process under Section 9 of the Acquisition Act is not legislative is correct in law. In view of our conclusions on the four questions formulated, this question is not of much relevance but since the High Court has recorded a conclusion and the learned Additional Solicitor General and Shri Salve advanced the argument we think it appropriate to answer this question also. The High Court relied upon the decision in *Shephard case* [(1987) 4 SCC 431 : 1987 SCC (L&S) 438 : (1988) 1 SCR 188] and came to hold that the provisions of Section 45 of the Banking Regulation Act being in *pari materia* with Section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, and the scheme framed under Section 45 of the Banking Regulation Act, 1949 having been held by this Court to be not legislative, the scheme framed under the Acquisition Act as in the present case, must also be held to be not a legislative one. It is undisputed that in *Shephard case* [(1987) 4 SCC 431 : 1987 SCC (L&S) 438 : (1988) 1 SCR 188] the amalgamation was of a private bank with a nationalised bank and the provisions of the Banking Regulation Act, 1949 applied. This Court in *Shephard case* [(1987) 4 SCC 431 : 1987 SCC (L&S) 438 : (1988) 1 SCR 188] on examining Section 45(11) of the Banking Regulation Act, 1949 came to hold that merely because a scheme framed is required to be laid before both the Houses of Parliament after the same has been sanctioned by the Central Government the scheme cannot be held to be legislative in nature. But in our considered opinion the High Court has failed to notice the fundamental distinction between the provisions of Section 45 of the Banking Regulation Act, 1949 and Section 9 of the Acquisition Act. Under Section 9 of the Acquisition Act under which Act the impugned scheme has been

> framed, every scheme framed by the Central Government has to be laid before each House of Parliament for a total period of 30 days and Parliament has the power to agree to the scheme and making any modification or in giving to a decision that the scheme should not be made and it is only thereafter the scheme has the effect either in the modified form or does not agree (*sic*). The essential distinction between the two provisions therefore, is that whereas under the Banking Regulation Act, 1949 the scheme framed has merely to be placed before Parliament and nothing further but under the Acquisition Act the scheme becomes effective only after the same is placed before both the Houses of Parliament and after Parliament makes such modification and agrees to the scheme. In this view of the matter the decision of this Court in *Shephard case* [(1987) 4 SCC 431 : 1987 SCC (L&S) 438 : (1988) 1 SCR 188] has no application to a scheme framed under the provisions of the Acquisition Act and in our considered opinion, a scheme framed under Section 9 of the Banking Companies Acquisition and Transfer of Undertakings Act, 1980, is a legislative one. The High Court was in error in holding the scheme not to be a legislative one."

Since Section 396(5) of the Companies Act is a provision akin to the provision considered in the case of **K.I. Shephard** (supra), the ratio of **K.I. Shephard** (supra) squarely applies. The judgment in **New Bank of India Employees' Union** (supra), therefore, is of no assistance, given the statutory provision in the present case.

31. Learned Senior Advocates on behalf of the respondents then cited the judgment in **Quarry Owners' Association v. State of Bihar and Ors.**, (2000) 8 SCC 655. This judgment, in paragraphs 45 and 55,

held that even a simple laying of an order before Parliament is a mandatory condition to be observed, and ordered that the particular order in that case be laid before the legislature as it had not so been laid earlier. This judgment again has nothing to do with whether, on account of laying before the legislature, an order is administrative or legislative in nature. This judgment also, therefore, does not carry us very much further.

32. Learned Senior Advocates on behalf of the respondents then cited a passage from **J.K. (Bombay) (P) Ltd.** (supra), and paragraph 23 in particular, in which this Court observed that an order made under Section 391 of the Companies Act has statutory force. The fact that a similar order made under Section 396 may also have statutory force again does not answer the precise question before us, namely, as to whether such orders having statutory force are administrative or legislative in nature. This observation again does not carry the matter very much further.

33. The order passed under Section 396 is *qua* particular companies and does not lay down any general rule of conduct by itself, but in fact, follows the general rule of conduct laid down by Section 396. Thus, the Central Government order, made under Section 396, must conform to

the fundamental rights guaranteed by Articles 14 and 19(1)(g) of the Constitution of India. This Court has held in a catena of decisions that it is the substance of what is effected that counts when it comes to infraction of a fundamental right, and not the form. Thus, in **Thomas Dana v. State of Punjab**, [1959] Supp (1) SCR 274, Subba Rao, J., in his dissenting opinion, stated:

> "A fundamental right is transcendental in nature and it controls both the legislative and the executive acts. Article 13 explicitly prohibits the State from making any law which takes away or abridges any fundamental right and declares the law to the extent of the contravention as void. The law therefore must be carefully scrutinized to ascertain whether a fundamental right is infringed. It is not the form but the substance that matters. If the legislature in effect constitutes a judicial tribunal, but calls it an authority, the tribunal does not become any the less a judicial tribunal. Therefore, the correct approach is first to ascertain with exactitude the content and scope of the fundamental right and then to scrutinize the provisions of the Act to decide whether in effect and substance, though not in form, the said right is violated or curtailed. Otherwise the fundamental right will be lost or unduly restricted in our adherence to the form to the exclusion of the content."
>
> (at p. 303)

Likewise, in **Hamdard Dawakhana (Wakf) Lal Kuan, Delhi and Anr. v. Union of India and Ors.**, [1960] 2 SCR 671, it was held as under:

> "In the present case therefore (*1*) the advertisements affected by the Act do not fall within the words freedom of speech within Article 19(1)(*a*); (*2*) the scope and object of the Act, its true nature and character is not interference with the right of freedom of speech

but it deals with trade or business; and (*3*) there is no direct abridgement of the right of free speech and a mere incidental interference with such right would not alter the character of the law; *Ram Singh* v. *State of Delhi* [(1951) SCR 451-455]; *Express Newspapers (Private) Ltd.* v. *Union of India* [(1959) SCR 12, 123-133]

It is not the form or incidental infringement that determines the constitutionality of a statute in reference to the rights guaranteed in Art. 19(1), but the reality and substance. The Act read as a whole does not merely prohibit advertisements relating to drugs and medicines connected with diseases expressly mentioned in s. 3 of the Act but they cover all advertisements which are objectionable or unethical and are used to promote self-medication or self-treatment. This is the content of the Act. Viewed in this way, it does not select any of the elements or attributes of freedom of speech falling within Art. 19(1)(a) of the Constitution."

(at pp. 690-691)

Likewise, in **Sakal Papers (P) Ltd. and Ors. v. Union of India**, [1962] 3 SCR 842, this Court held:

"It must be borne in mind that the Constitution must be interpreted in a broad way and not in a narrow and pedantic sense. Certain rights have been enshrined in our Constitution as fundamental and, therefore, while considering the nature and content of those rights the Court must not be too astute to interpret the language of the Constitution in so literal a sense as to whittle them down. On the other hand the Court must interpret the Constitution in a manner which would enable the citizen to enjoy the rights guaranteed by it in the fullest measure subject, of course, to permissible restrictions. Bearing this principle in mind it would be clear that the right to freedom of speech and expression carries with it the right to publish and circulate one's ideas, opinions and views with complete freedom and by resorting to any available means of publication, subject again to such restrictions as could be legitimately imposed under

clause (2) of Article 19. ……. In *Dwarkadas Shrinivas v. Sholapur Spinning & Weaving Co. Ltd.* [(1954) SCR 674] this Court has pointed out that in construing the Constitution it is the substance and the practical result of the act of the State that should be considered rather than its purely legal aspect. The correct approach in such cases should be to enquire as to what in substance is the loss or injury caused to the citizen and not merely what manner and method has been adopted by the State in placing the restriction."

(at pp. 857-858)

A Constitution Bench in **Ajay Hasia and Ors. v. Khalid Mujib Sehravardi and Ors.**, (1981) 1 SCC 722 also stated:

"**7.** While considering this question it is necessary to bear in mind that an authority falling within the expression "other authorities" is, by reason of its inclusion within the definition of 'State' in Article 12, subject to the same constitutional limitations as the government and is equally bound by the basic obligation to obey the constitutional mandate of the Fundamental Rights enshrined in Part III of the Constitution. We must therefore give such an interpretation to the expression "other authorities" as will not stultify the operation and reach of the fundamental rights by enabling the government to its obligation in relation to the Fundamental Rights by setting up an authority to act as its instrumentality or agency for carrying out its functions. Where constitutional fundamentals vital to the maintenance of human rights are at stake, functional realism and not facial cosmetics must be the diagnostic tool, for constitutional law must seek the substance and not the form. Now it is obvious that the Government may act through the instrumentality or agency of natural persons or it may employ the instrumentality or agency of juridical persons to carry out its functions. In the early days when the Government had limited functions, it could operate effectively through natural persons constituting its civil service and they were found

> adequate to discharge governmental functions which were of traditional vintage. But as the tasks of the government multiplied with the advent of the welfare State, it began to be increasingly felt that the framework of civil service was not sufficient to handle the new tasks which were often specialised and highly technical in character and which called for flexibility of approach and quick decision making. The inadequacy of the civil service to deal with these new problems came to be realised and it became necessary to forge a new instrumentality or administrative device for handling these new problems. It was in these circumstances and with a view to supplying this administrative need that the corporation came into being as the third arm of the government and over the years it has been increasingly utilised by the government for setting up and running public enterprises and carrying out other public functions. ……"

Also, in **M.C. Mehta and Anr. v. Union of India and Ors. (Shriram – Oleum Gas)**, (1987) 1 SCC 395, this Court held:

> "**2.** Mr Divan, learned counsel appearing on behalf of Shriram raised a preliminary objection that the court should not proceed to decide these constitutional issues since there was no claim for compensation originally made in the writ petition and these issues could not be said to arise on the writ petition. Mr Divan conceded that the escape of oleum gas took place subsequent to the filing of the writ petition but his argument was that the petitioner could have applied for amendment of the writ petition so as to include a claim for compensation for the victims of oleum gas but no such application for amendment was made and hence on the writ petition as it stood, these constitutional issues did not arise for consideration. We do not think this preliminary objection raised by Mr Divan is sustainable. It is undoubtedly true that the petitioner could have applied for amendment of the writ petition so as to include a claim for compensation but merely because he did not do so, the

> applications for compensation made by the Delhi Legal Aid and Advice Board and the Delhi Bar Association cannot be thrown out. These applications for compensation are for enforcement of the fundamental right to life enshrined in Article 21 of the Constitution and while dealing with such applications, we cannot adopt a hyper-technical approach which would defeat the ends of justice. This Court has on numerous occasions pointed out that where there is a violation of a fundamental or other legal right of a person or class of persons who by reason of poverty or disability or socially or economically disadvantaged position cannot approach a court of law for justice, it would be open to any public spirited individual or social action group to bring an action for vindication of the fundamental or other legal right of such individual or class of individuals and this can be done not only by filing a regular writ petition but also by addressing a letter to the court. If this Court is prepared to accept a letter complaining of violation of the fundamental right of an individual or a class of individuals who cannot approach the court for justice, there is no reason why these applications for compensation which have been made for enforcement of the fundamental right of the persons affected by the oleum gas leak under Article 21 should not be entertained. The court while dealing with an application for enforcement of a fundamental right must look at the substance and not the form. We cannot therefore sustain the preliminary objection raised by Mr Divan."

34. Various pre-requisites contained in the said Section must first be satisfied before the Section can be said to operate. First and foremost, the Central Government has to be "satisfied", meaning thereby, that it must, on certain objective facts, come to a conclusion that amalgamation between two or more companies is necessary. This can only be done if the Central Government finds it "essential", i.e.,

necessary to do so. Also, this can only be done in “public interest” (the Section originally contained the expression “national interest”. By Amendment Act 65 of 1960, “national interest” was substituted by “public interest”).

35. The Notes on Clauses relating to the original Section 396 reads as follows:

> “**Clause 366**—This is a new provision and it is intended to provide, at the instance of the Government, for the amalgamation of two or more companies in the national interest. Occasionally, cases arise where such an amalgamation in the national interest is clearly a necessity. The observance of the usual procedure prescribed by the existing Act in such cases will lead to prolonged delays which will be detrimental to the national interest. It has been made clear that any order made by the Government should provide for the old shareholders, and the old debenture holders and other creditors, having the same interest in the company resulting from the amalgamation as they had in the original companies. Any order made by the Government under this clause will be laid on the table of both Houses of Parliament and will therefore be subject to the Parliamentary scrutiny.”

What is important from the Notes on Clauses is the fact that it is only “occasionally” that cases arise where an amalgamation in national interest is “clearly a necessity”. It is made clear that the reason for Section 396 is that the observance of the usual procedure prescribed by the existing Act (namely, that contained in Sections 391 to 394) in

such cases will lead to prolonged delays, which will be detrimental to national interest. The fact that the procedure contained in Sections 394 and 395 need not be carried out is made clear in the non-obstante clause contained in Section 396(1).

36. Section 396(3), (3A), and (4) are also important. A condition precedent to the passing of an order by the Central Government under this Section is that every member or creditor of each of the companies before amalgamation shall have, as nearly as may be, the same interest in or rights against the company resulting from the amalgamation as he had in the erstwhile company either as a member or a creditor, and if this is not so, such member or creditor shall be entitled to compensation which is to be assessed by such authority as may be prescribed. From the order of such assessment, an appeal is provided by sub-section (3A). What is important is the mandatory language contained in sub-section (4), which states that no order shall be made under the Section unless the time for preferring an appeal under sub-section (3A) has expired, or where any such appeal has been preferred, the appeal has been finally disposed of. This makes it clear that unless an order of compensation is first made under sub-section (3), and an appeal therefrom has either not been filed or has been disposed of, no order of amalgamation can be made. Another

condition precedent is an inbuilt provision for natural justice, namely, that a proposed draft order has first been sent to each of the companies concerned. The companies may then send suggestions or objections to the Central Government, which the Central Government must first consider before passing the final order. Such objections and suggestions can also be sent from any class of shareholders of either of the companies, or from any creditors or class of creditors of either of the companies.

"WHERE THE CENTRAL GOVERNMENT IS SATISFIED"

37. With regard to similar language that is contained in Section 237(b) of the Companies Act, 1956, this Court, in **Barium Chemicals** (supra), contained separate opinions as to what the phrase "in the opinion of" contained in Section 237(b) meant. In **Rohtas Industries** (supra), this Court adopted the test laid down by Hidayatullah, J. (as he then was) and Shelat, J. as follows:

> "Before taking action under Section 237(*b*)(*i*) and (*ii*), the Central Government has to form an opinion that there are circumstances suggesting that the business of the company is being conducted with intent to defraud its creditors, members or any other persons, or otherwise for a fraudulent or unlawful purpose or in a manner oppressive to any member or that the company was formed for any fraudulent or unlawful purpose or that the persons concerned in the formation or the management of its affairs have in connection therewith been guilty of

fraud, misfeasance or other misconduct towards the company or towards any of its members.

From the facts placed before us, it is clear that the Government had not bestowed sufficient attention to the material before it before passing the impugned order. It seems to have been oppressed by the opinion that it had formed about Shri S.P. Jain. From the arguments advanced by Mr Attorney, it is clear that but for the association of Mr S.P. Jain with the appellant-company, the investigation in question, in all probabilities would not have been ordered. Hence, it is clear that in making the impugned order irrelevant considerations have played an important part.

The power under Sections 235 to 237 has been conferred on the Central Government on the faith that it will be exercised in a reasonable manner. The department of the Central Government which deals with companies is presumed to be an expert body in company law matters. Therefore, the standard that is prescribed under Section 237(*b*) is not the standard required of an ordinary citizen but that of an expert. The learned Attorney did not dispute the position that if we come to the conclusion that no reasonable authority would have passed the impugned order on the material before it, then the same is liable to be struck down. This position is also clear from the decision of this Court in *Barium Chemicals and Anr.* v. *Company Law Board and Anr.* [(1966) Supp SCR 311].

(at p. 119)

xxx xxx xxx

The decision of this Court in *Barium Chemicals* case which considered the scope of Section 237(*b*) illustrates that difficulty. In that case Hidayatullah, J. (our present Chief Justice) and Shelat, J. came to the conclusion that though the power under Section 237(*b*) is a discretionary power the first requirement for its exercise is the honest formation of an opinion that the investigation is necessary and the further requirement is that “there are circumstances suggesting” the inference set out in the section; an action not based on circumstances suggesting an inference of the enumerated kind will not

be valid; the formation of the opinion is subjective but the existence of the circumstances relevant to the inference as the *sine qua non* for action must be demonstratable; if their existence is questioned, it has to be proved at least *prime facie*; it is not sufficient to assert that those circumstances exist and give no clue to what they are, because the circumstances must be such as to lead to conclusions of certain definiteness; the conclusions must relate to an intent to defraud, a fraudulent or unlawful purpose, fraud or misconduct. In other words they held that although the formation of opinion by the Central Government is a purely subjective process and such an opinion cannot be challenged in a court on the ground of propriety, reasonableness or sufficiency, the authority concerned is nevertheless required to arrive at such an opinion from circumstances suggesting the conclusion set out in sub-clauses (*i*), (*ii*) and (*iii*) of Section 237(b) and the expression "circumstances suggesting" cannot support the construction that even the existence of circumstances is a matter of subjective opinion. Shelat, J. further observed that it is hard to contemplate that the Legislature could have left to the subjective process both the formation of opinion and also the existence of circumstances on which it is to be founded; it is also not reasonable to say that the clause permitted the Authority to say that it has formed the opinion on circumstances which in its opinion exist and which in its opinion suggest an intent to defraud or a fraudulent or unlawful purpose.

On the other hand Sarkar, C.J. and Mudholkar, J. held that the power conferred on the Central Government under Section 237(*b*) is a discretionary power and no facet of that power is open to judicial review. Our Brother Bachawat, J., the other learned Judge in that Bench did not express any opinion on this aspect of the case. Under these circumstances it has become necessary for us to sort out the requirements of Section 237(*b*) and to see which of the two contradictory conclusions reached in *Barium Chemicals* case is in our judgment, according to law. But before proceeding to analyse Section 237(*b*) we should like to refer to certain decisions cited at the bar bearing on the question under consideration.

(at pp. 120-121)

xxx xxx xxx

"Coming back to Section 237(*b*), in finding out its true scope we have to bear in mind that that section is a part of the scheme referred to earlier and therefore the said provision takes its colour from Sections 235 and 236. In finding out the legislative intent we cannot ignore the requirements of those sections. In interpreting Section 237(*b*) we cannot ignore the adverse effect of the investigation on the company. Finally we must also remember that the section in question is an inroad on the powers of the company to carry on its trade or business and thereby an infraction of the fundamental right guaranteed to its shareholders under Article 19(1)(*g*) and its validity cannot be upheld unless it is considered that the power in question is a reasonable restriction in the interest of the general public. In fact the *vires* of that provision was upheld by majority of the Judges constituting the Bench in *Barium Chemicals* case principally on the ground that the power conferred on the Central Government is not an arbitrary power and the same has to be exercised in accordance with the restraints imposed by law. For the reasons stated earlier we agree with the conclusion reached by Hidayatullah, J. and Shelat, JJ. in *Barium Chemicals* case that the existence of circumstances suggesting that the company's business was being conducted as laid down in sub-clause(1) or the persons mentioned in sub-clause (2) were guilty of fraud or misfeasance or other misconduct towards the company or towards any of its members is a condition precedent for the Government to form the required opinion and if the existence of those conditions is challenged, the courts are entitled to examine whether those circumstances were existing when the order was made. In other words, the existence of the circumstances in question are open to judicial review though the opinion formed by the Government is not amenable to review by the courts. As held earlier the required circumstances did not exist in this case."

(at pp. 128-129)

38. In **Western U.P. Electric Power & Supply Co. Ltd. v. State of U.P. and Anr.**, (1969) 1 SCC 817, this Court dealt with a situation where the Indian Electricity Act, 1910 was amended by the U.P. Act 30 of 1961, by which, Section 3(2)(e)(ii) provided that the grant of a licence shall not, in any way, hinder or restrict the supply of energy by the State Government or the State Electricity Board within the same area where the State Government deems such supply "necessary in public interest". In that case, the High Court had observed that the State Government was the sole judge of whether the direct supply of energy was or was not in public interest, the nature of the power being subjective. This Court, in upsetting the High Court's view, held:

> "**11.** We are unable to agree with that view. By Section 3(2)(*e*) as amended by the U.P. Act 30 of 1961, the Government is authorised to supply energy to consumers within the area of the licensee in certain conditions: exercise of the power is conditioned by the Government deeming it necessary in public interest to make such supply. If challenged, the Government must show that exercise of the power was necessary in public interest. The Court is thereby not intended to sit in appeal over the satisfaction of the Government. If there be *prima facie* evidence on which a reasonable body of persons may hold that it is in the public interest to supply energy directly to the consumers, the requirements of the statute are fulfilled. Normally a licensee of electrical energy, though he has no monopoly, is the person through whom electrical energy would be distributed within the area of supply, since the licensee has to lay down electric supply-lines for transmission of energy and to maintain its establishment. An inroad may be made in

> that right in the conditions which are statutorily prescribed. In our judgment, the satisfaction of the Government that the supply is necessary in the public interest is in appropriate cases not excluded from judicial review."

39. Close upon the heels of these judgments, this Court, after considering **Barium Chemicals** (supra) and **Rohtas Industries** (supra), restated the test as to judicial review of administrative action in **Rampur Distillery Co. Ltd. v. Company Law Board**, [1970] 2 SCR 177 as follows:

> "The scheme of the section implies investigation and a decision on the matters set out therein. Section 326 lays down conditions by sub-section (1)(*a*) in which the Central Government may override the resolution of the general body of share-holders in certain specified conditions. Upon the Central Government is imposed a duty not to accord approval to the appointment or re-appointment of a proposed managing agent in the light of clauses (*a*), (*b*) and (*c*) of sub-section (2). Though the sub-section is enacted in form negative, in substance it confers power upon the Government subject to the restrictions imposed by clauses (*a*), (*b*) and (*c*), to refuse to accord approval. Sub-section (2) imposes upon the Central Government the duty not to accord approval to appointment or re-appointment of a proposed managing agent unless the Government is satisfied that the managing agent is a fit and proper person to be appointed, that the conditions of the managing agency agreement are fair and reasonable and that the managing agent has fulfilled the conditions which the Central Government required him to fulfil. Thereby the Central Government is not made the final arbiter of the existence of the grounds on which the satisfaction may be founded. The satisfaction of the Government which is determinative is satisfaction as to the existence of

certain objective facts. The recital about satisfaction may be displaced by showing that the conditions did not exist, or that no reasonable body of persons properly versed in law could have reached the decision that they did.

The Courts, however, are not concerned with the sufficiency of the grounds on which the satisfaction is reached. What is relevant is the satisfaction of the Central Government about the existence of the conditions in clauses (*a*), (*b*) and (*c*) of sub-section (2) of Section 326. The enquiry before the Court, therefore, is whether the Central Government was satisfied as to the existence of the conditions. The existence of the satisfaction cannot be challenged except probably on the ground that the authority acted mala fide. But if in reaching its satisfaction the Central Government misapprehended the nature of the conditions, or proceeded upon irrelevant materials, or ignores relevant materials, the jurisdiction of the Courts to examine the satisfaction is not excluded. ……"

(at p. 183)

In **M.A. Rasheed and Ors. v. State of Kerala**, [1975] 2 SCR 93, after following **Rohtas Industries** (supra), the test for judicial review of administrative decisions was stated most felicitously by Ray, C.J. thus:

"Administrative decisions in exercise of powers even if conferred in subjective terms are to be made in good faith on relevant consideration. The courts inquire whether a reasonable man could have come to the decision in question without misdirecting himself on the law or the facts in a material respect. The standard of reasonableness to which the administrative body is required to conform may range from the courts' own opinion of what is reasonable to the criterion of what a reasonable body might have decided. The courts will find out whether conditions precedent to the formation of the opinion have a factual basis."

(at p. 99)

In **Khudiram Das v. State of West Bengal**, (1975) 2 SCC 81, this Court exhaustively set out parameters for judicial review of the subjective satisfaction of the detaining authority in a preventive detention case. This Court held:

> "**9.** But that does not mean that the subjective satisfaction of the detaining authority is wholly immune from judicial reviewability. The courts have by judicial decisions carved out an area, limited though it be, within which the validity of the subjective satisfaction can yet be subjected to judicial scrutiny. The basic postulate on which the courts have proceeded is that the subjective satisfaction being a condition precedent for the exercise of the power conferred on the Executive, the Court can always examine whether the requisite satisfaction is arrived at by the authority : if it is not, the condition precedent to the exercise of the power would not be fulfilled and the exercise of the power would be bad. There are several grounds evolved by judicial decisions for saying that no subjective satisfaction is arrived at by the authority as required under the statute. The simplest case is whether the authority has not applied its mind at all; in such a case the authority could not possibly be satisfied as regards the fact in respect of which it is required to be satisfied. *Emperor* v. *Shibnath Bannerji* [AIR 1943 FC 75 : 1944 FCR 1 : 45 Cri LJ 341] is a case in point. Then there may be a case where the power is exercised dishonestly or for an improper purpose : such a case would also negative the existence of satisfaction on the part of the authority. The existence of "improper purpose", that is, a purpose not contemplated by the statute, has been recognised as an independent ground of control in several decided cases. The satisfaction, moreover, must be a satisfaction of the authority itself, and therefore, if, in exercising the power, the authority has acted under the dictation of another body as the Commissioner of Police did in *Commissioner of Police* v. *Gordhandas Bhanji* [AIR 1952 SC 16 : 1952 SCR 135]

> and the officer of the Ministry of Labour and National Service did in *Simms Motor Units Ltd.* v. *Minister of Labour and National Service* [(1946) 2 All ER 201] the exercise of the power would be bad and so also would the exercise of the power be vitiated where the authority has disabled itself from applying its mind to the facts of each individual case by self-created rules of policy or in any other manner. The satisfaction said to have been arrived at by the authority would also be bad where it is based on the application of a wrong test or the misconstruction of a statute. Where this happens, the satisfaction of the authority would not be in respect of the thing in regard to which it is required to be satisfied. Then again, the satisfaction must be grounded "on materials which are of rationally probative value". *Machindar* v. *King* [AIR 1950 FC 129 : 51 Cri LJ 1480 : 1949 FCR 827]. The grounds on which the satisfaction is based must be such as a rational human being can consider connected with the fact in respect of which the satisfaction is to be reached. They must be relevant to the subject-matter of the inquiry and must not be extraneous to the scope and purpose of the statute. If the authority has taken into account, it may even be with the best of intention, as a relevant factor something which it could not properly take into account in deciding whether or not to exercise the power or the manner or extent to which it should be exercised, the exercise of the power would be bad. *Pratap Singh* v. *State of Punjab* [AIR 1964 SC 72 : (1964) 4 SCR 733]. If there are to be found in the statute expressly or by implication matters which the authority ought to have regard to, then, in exercising the power, the authority must have regard to those matters. The authority must call its attention to the matters which it is bound to consider."

In **Tata Cellular v. Union of India** (1994) 6 SCC 651, after an exhaustive review of the latest English judgments, this Court held:

> "**77.** The duty of the court is to confine itself to the question of legality. Its concern should be:

1. Whether a decision-making authority exceeded its powers?
2. committed an error of law,
3. committed a breach of the rules of natural justice,
4. reached a decision which no reasonable tribunal would have reached or,
5. abused its powers.

Therefore, it is not for the court to determine whether a particular policy or particular decision taken in the fulfilment of that policy is fair. It is only concerned with the manner in which those decisions have been taken. The extent of the duty to act fairly will vary from case to case. Shortly put, the grounds upon which an administrative action is subject to control by judicial review can be classified as under:

(i) Illegality: This means the decision-maker must understand correctly the law that regulates his decision-making power and must give effect to it.
(ii) Irrationality, namely, Wednesbury unreasonableness.
(iii) Procedural impropriety.

The above are only the broad grounds but it does not rule out addition of further grounds in course of time. As a matter of fact, in *R.* v. *Secretary of State for the Home Department, ex Brind* [(1991) 1 AC 696], Lord Diplock refers specifically to one development, namely, the possible recognition of the principle of proportionality. In all these cases the test to be adopted is that the court should, "consider whether something has gone wrong of a nature and degree which requires its intervention"."

40. In **Bhikhubhai Vithlabhai Patel v. State of Gujarat**, (2008) 4 SCC 144, this Court, in an elaborate judgment, referred to and followed several judgments, including **Barium Chemicals** (supra), in the context of Section 17 of the Gujarat Town Planning and Urban

Development Act, 1976, by which, if the State Government is of opinion that substantial modifications in the draft development plan are necessary, it may publish such modifications. This Court held:

> "**20.** The State Government is entitled to publish the modifications provided it is of opinion that substantial modifications in the draft development plan are necessary. The expression "'is of opinion' that substantial modifications in the draft development plan are necessary" is of crucial importance. Is there any material available on record which enabled the State Government to form its opinion that substantial modifications in the draft development plan were necessary? The State Government's jurisdiction to make substantial modifications in the draft development plan is intertwined with the formation of its opinion that such substantial modifications are necessary in the draft development plan. The State Government without forming any such opinion cannot publish the modifications considered necessary along with notice inviting suggestions or objections. We have already noticed that as on the day when the Minister concerned took the decision proposing to designate the land for educational use the material available on record were:
>
> (*a*) the opinion of the Chief Town Planner;
>
> (*b*) note dated 23-4-2004 prepared on the basis of the record providing the entire background of the previous litigation together with the suggestion that the land should no more be reserved for the purpose of South Gujarat University and after releasing the lands from reservation, the same should be placed under the residential zone.
>
> **21.** It is true that the State Government is not bound by such opinion and is entitled to take its own decision in the matter provided there is material available on record to form opinion that substantial modifications in the draft development plan were necessary. Formation of opinion is a condition precedent for setting the law in motion

proposing substantial modifications in the draft development plan.

22. Any opinion of the Government to be formed is not subject to objective test. The language leaves no room for the relevance of a judicial examination as to the sufficiency of the grounds on which the Government acted in forming its opinion. But there must be material based on which alone the State Government could form its opinion that it has become necessary to make substantial modification in the draft development plan.

23. The power conferred by Section 17(1)(*a*)(*ii*) read with proviso is a conditional power. It is not an absolute power to be exercised in the discretion of the State Government. The condition is formation of opinion—subjective, no doubt—that it had become necessary to make substantial modifications in the draft development plan. This opinion may be formed on the basis of material sent along with the draft development plan or on the basis of relevant information that may be available with the State Government. The existence of relevant material is a precondition to the formation of opinion. The use of word "may" indicates not only a discretion but an obligation to consider that a necessity has arisen to make substantial modifications in the draft development plan. It also involves an obligation to consider which of the several steps specified in sub-clauses (*i*), (*ii*) and (*iii*) should be taken.

24. The proviso opens with the words "where the State Government is of opinion that substantial modifications in the draft development plan and regulations are necessary, …". These words are indicative of the satisfaction being subjective one but there must exist circumstances stated in the proviso which are conditions precedent for the formation of the opinion. Opinion to be formed by the State Government cannot be on imaginary grounds, wishful thinking, however laudable that may be. Such a course is impermissible in law. The formation of the opinion, though subjective, must be based on the material disclosing that a necessity had arisen to make substantial modifications in the draft development plan.

> **25.** The formation of the opinion by the State Government is with reference to the necessity that may have had arisen to make substantial modifications in the draft development plan. The expression: "as considered necessary" is again of crucial importance. The term "consider" means to think over; it connotes that there should be active application of the mind. In other words, the term "consider" postulates consideration of all the relevant aspects of the matter. A plain reading of the relevant provision suggests that the State Government may publish the modifications only after consideration that such modifications have become necessary. The word "necessary" means indispensable, requisite, indispensably requisite, useful, incidental or conducive, essential, unavoidable, impossible to be otherwise, not to be avoided, inevitable. The word "necessary" must be construed in the connection in which it is used. (See *Advanced Law Lexicon*, P. Ramanatha Aiyar, 3rd Edn., 2005.)
>
> **26.** The formation of the opinion by the State Government should reflect intense application of mind with reference to the material available on record that it had become necessary to propose substantial modifications to the draft development plan."

41. However, Shri Tushar Mehta, learned Solicitor General for India, relied upon **M. Jhangir Bhatusha and Ors. v. Union of India and Ors.**, 1989 Supp (2) SCC 201, in particular, the passage at page 208 which reads as follows:

> "**13.** …… Now it is the Central Government which has to be satisfied, as the authority appointed by Parliament under Section 25(2), that it is necessary in the public interest to make the special orders of exemption. It has set out the reasons which prompted it to pass the orders. In our opinion, the circumstances mentioned in those notifications cannot be said to be irrelevant or unreasonable. It is not for this Court to sit in judgment on

> the sufficiency of those reasons. The limitations on the jurisdiction of the court in cases where the satisfaction has been entrusted to executive authority to judge the necessity for passing orders is well defined and has been long accepted."

These observations were made in the context of an argument that differential treatment was accorded to the State Trading Corporation vis-à-vis private importers in that the customs duty for the State Trading Corporation had been reduced by notification under Section 25(2) of the Customs Act, 1962. What is important to note is that judicial review consisted of examining whether the reasons which prompted the Government to pass the exemption orders could be said to be irrelevant or unreasonable. If so, the orders would be struck down in exercise of judicial review.

42. Thus, at the very least, it is clear that the Central Government's satisfaction must be as to the conditions precedent mentioned in the Section as correctly understood in law, and must be based on facts that have been gathered by the Central Government to show that the conditions precedent exist when the order of the Central Government is made. There must be facts on which a reasonable body of persons properly instructed in law may hold that it is essential in public interest to amalgamate two or more companies. The formation of satisfaction

cannot be on irrelevant or imaginary grounds, as that would vitiate the exercise of power.

"ESSENTIAL"

43. The expression "essential" has been defined in P. Ramanath Aiyer's Law Lexicon (4th Edn.) as follows:

> "**Essential**. Indispensably necessary; important in the highest degree: requisite that which is required for the continued existence of a thing."

Black's Law Dictionary (10th Edn.) defines "essential" as follows:

> "**essential**, adj. (14c) **1**. Of, relating to, or involving the essence or intrinsic nature of something. **2**. Of the utmost importance; basic and necessary. **3.** Having real existence; actual."

44. In **J. Jayalalitha v. Union of India**, (1999) 5 SCC 138, this Court dealt with an argument that there is no guideline contained in Section 3(1) of the Prevention of Corruption Act, 1988, when the Section empowers the Government to appoint as many Special Judges "as may be necessary". It was stated that this word has a precise meaning and means "what is indispensable, needful or essential" [*see* paragraph 14]. It is thus clear that the Central Government's mind has to be applied to whether a compulsory amalgamation under Section

396 is indispensably necessary, important in the highest degree, and whether such amalgamation is both basic and necessary.

"PUBLIC INTEREST"

45. The third pre-requisite of Section 396 is that the Central Government must apply its mind when compulsorily amalgamating two or more companies in the public interest. "Public interest" is an expression which is wide and amorphous and takes colour from the context in which it is used. However, like the expression "public purpose", what is important to be noted is that public interest is the general interest of the community, as distinguished from the private interest of an individual [*see* **State of Bihar v. Maharajadhiraja Sir Kameshwar Singh of Darbhanga and Ors.**, [1952] 3 SCR 889 at pp. 1073-1075].

46. This is echoed in **Manimegalai v. Special Tehsildar (Land Acquisition Officer) Adi Dravidar Welfare**, (2018) 13 SCC 491 as follows:

> "**14.** Similarly, public purpose is not capable of precise definition. Each case has to be considered in the light of the purpose for which acquisition is sought for. It is to serve the general interest of the community as opposed to the particular interest of the individual. Public purpose broadly speaking would include the purpose in which the general interest of the society as opposed to the

particular interest of the individual is directly and vitally concerned. Generally, the executive would be the best judge to determine whether or not the impugned purpose is a public purpose. Yet it is not beyond the purview of judicial scrutiny. The interest of a section of the society may be public purpose when it is benefitted by the acquisition. The acquisition in question must indicate that it was towards the welfare of the people and not to benefit a private individual or group of individuals joined collectively. Therefore, acquisition for anything which is not for a public purpose cannot be done compulsorily."

(emphasis supplied)

47. In the context of the Motor Vehicles Act, 1939, in **Rameshwar Prasad and Ors. v. State of U.P. and Ors.**, (1983) 2 SCC 195, this Court held:

"**19.** ……. What does Section 43-A(1) after all say? It says that the State Government may issue such directions of a general character as it may consider necessary in the public interest. What is the meaning of the term "public interest"? In the context of the Act, it takes within its fold several factors such as, the maximum number of permits that may be issued on a route or in any area having regard to the needs and convenience of the travelling public, the non-availability of sufficient number of stage carriage services in other routes or areas which may be in need of running of additional services, the problems of law and order, availability of fuel, problems arising out of atmospheric pollution caused by a large number of motor vehicles operating in any route or area, the condition of roads and bridges on the routes, uneconomic running of stage carriage services leading to elimination of small operators and employment of more capital than necessary in any sector leading to starvation of capital investment in other sectors etc. Public interest under the Act does not mean the interest of the operators or of the passengers only. We have to bear in mind that like every

other economic activity the running of stage carriage service is an activity which involves use of scarce or limited productive resources. Motor transport involves a huge capital investment on motor vehicles, training of competent drivers and mechanics, establishment of workshops, construction of safe roads and bridges, deployment of sufficient number of policemen to preserve law and order and several other matters. To say that larger the number of stage carriages in any route or area more convenient it would be to the members of the public is an oversimplification of a problem with myriad facets affecting the general public. If we run through the various provisions of the Act it becomes clear how much attention is given by it to various matters affecting public interest. There are provisions relating to licensing of drivers on the basis of their competence, licensing of conductors, specifications to which the motor vehicles should conform, coordination of road and rail transport, prevention of deterioration of the road system, prevention of uneconomic competition among motor vehicles, fixation of reasonable fare, compliance by motor vehicles with the prescribed timetable, construction of bus stands with necessary amenities, maintenance of standards of comfort and cleanliness in the vehicles, development of inter-state tourist traffic and several other matters with the object of making available adequate and efficient transport facilities to all parts of the country. Any direction given by the State Government under Section 43-A of the Act should, therefore, be in conformity with all matters regarding which the statute has made provision. In this situation to say that any number of permits can be issued to any eligible operator without any upper limit is to overstep the limits of delegation of statutory power and to make a mockery of an important economic activity like the motor transport."

(emphasis supplied)

48. In **Janata Dal v. H.S. Chowdhary and Ors.**, (1992) 4 SCC 305, this Court referred to Stroud's Judicial Dictionary, which defines "public interest" thus:

> "**51.** In *Stroud's Judicial Dictionary*, Vol. IV (4th edn.) 'public interest' is defined thus:
>
> > "Public interest — 1. A matter of public or general interest does not mean that which is interesting as gratifying curiosity or a love of information or amusement; but that in which a class of the community have a pecuniary interest, or some interest by which their legal rights or liabilities are affected." (Per Cambel C.J., in *R.* v. *Bedfordshire* [24 LJ QB 84]).
>
> **52.** In *Black's Law Dictionary* (6th edn.), 'public interest' is defined as follows:
>
> > "Public Interest — Something in which the public, the community at large, has some pecuniary interest, or some interest by which their legal rights or liabilities are affected. It does not mean anything so narrow as mere curiosity, or as the interests of the particular localities, which may be affected by the matters in question. Interest shared by citizens generally in affairs of local, state or national government ……"

49. In **Municipal Corporation of the City of Ahmedabad and Ors. v. Jan Mohd. Usmanbhai and Anr.**, (1986) 3 SCC 20, this Court stated that the expression "in the interest of the general public" is of wide import comprehending public order, public health, public security, morals, economic welfare of the community, and the objects mentioned in Part IV of the Constitution of India [*see* paragraph 19].

50. Likewise, in **B.P. Sharma v. Union of India and Ors.**, (2003) 7 SCC 309, this Court held:

> "**15.** …… The phrase "in the interest of the general public" has come to be considered in several decisions and it has been held that it would comprise within its ambit interests like public health and morals (refer to *State of Maharashtra* v. *Himmatbhai Narbheram Rao* [AIR 1970 SC 1157 : (1969) 2 SCR 392]), economic stability (*State of Assam* v. *Sristikar Dowerah* [AIR 1957 SC 414]), stability of the country, equitable distribution of essential commodities at fair prices (*Union of India* v. *Bhanamal Gulzarimal Ltd.* [AIR 1960 SC 475 : 1960 Cri LJ 664]) for maintenance of purity in public life, prevention of fraud and similar considerations. ……"

51. Coming nearer home, **Hindustan Lever Employees' Union v. Hindustan Lever Ltd. and Ors.**, 1995 Supp (1) SCC 499, Sahai, J., in a concurring judgment, referred to "public interest" in Section 394 of the Companies Act as follows:

> "**5.** What requires, however, a thoughtful consideration is whether the company court has applied its mind to the public interest involved in the merger. In this regard the Indian law is a departure from the English law and it enjoins a duty on the court to examine objectively and carefully if the merger was not violative of public interest. No such provision exists in the English law. What would be public interest cannot be put in a strait-jacket. It is a dynamic concept which keeps on changing. It has been explained in *Black's Law Dictionary* as:
>
> > "Something in which the public, the community at large, has some pecuniary interest, or some interest by which their legal rights or liabilities are affected. It does not mean anything so narrow as mere curiosity, or as the interests of

> the particular locality which may be affected by the matters in question. Interest shared by citizens generally in affairs of local, State or national Government."

It is an expression of wide amplitude. It may have different connotation and understanding when used in service law and a yet different meaning in criminal law than civil law and its shade may be entirely different in company law. Its perspective may change when merger is of two Indian companies. But when it is with subsidiary of foreign company the consideration may be entirely different. It is not the interest of shareholders or the employees only but the interest of society which may have to be examined. And a scheme valid and good may yet be bad if it is against public interest.

6. Section 394 casts an obligation on the court to be satisfied that the scheme for amalgamation or merger was not contrary to public interest. The basic principle of such satisfaction is none other than the broad and general principles inherent in any compromise or settlement entered between parties that it should not be unfair or contrary to public policy or unconscionable. In amalgamation of companies, the courts have evolved, the principle of "prudent business management test" or that the scheme should not be a device to evade law. But when the court is concerned with a scheme of merger with a subsidiary of a foreign company then the test is not only whether the scheme shall result in maximising profits of the shareholders or whether the interest of employees was protected but it has to ensure that merger shall not result in impeding promotion of industry or shall obstruct growth of national economy. Liberalised economic policy is to achieve this goal. The merger, therefore, should not be contrary to this objective. Reliance on English decisions *Hoare & Co. Ltd., Re* [1933 All ER Rep 105, Ch D] and *Bugle Press Ltd., Re* [1961 Ch 270 : (1960) 1 All ER 768 : (1960) 2 WLR 658] that the power of the court is to be satisfied only whether the provisions of the Act have been complied with or that the class or classes were fully represented and the arrangement was such as a man of

business would reasonably approve between two private companies may be correct and may normally be adhered to but when the merger is with a subsidiary of a foreign company then economic interest of the country may have to be given precedence. The jurisdiction of the court in this regard is comprehensive."

(emphasis supplied)

52. In **Bihar Public Service Commission v. Saiyed Hussain Abbas Rizwi and Anr.**, (2012) 13 SCC 61, this Court referred to "public interest" in the context of service law as follows:

> "**22.** The expression "public interest" has to be understood in its true connotation so as to give complete meaning to the relevant provisions of the Act. The expression "public interest" must be viewed in its strict sense with all its exceptions so as to justify denial of a statutory exemption in terms of the Act. In its common parlance, the expression "public interest", like "public purpose", is not capable of any precise definition. It does not have a rigid meaning, is elastic and takes its colour from the statute in which it occurs, the concept varying with time and state of society and its needs (*State of Bihar* v. *Kameshwar Singh* [AIR 1952 SC 252]). It also means the general welfare of the public that warrants recognition and protection; something in which the public as a whole has a stake [*Black's Law Dictionary* (8th Edn.)]."

53. In **R.R. Tripathi v. Union of India**, (2010) 1 Bom CR 513, the Bombay High Court referred to the Business Dictionary, which defines "public interest" as follows:

> "welfare of the general public (in contrast to the selfish interest of a person, group, or firm) in which the whole society has a stake and which warrants recognition, promotion, and protection by the government and its

> agencies. Despite the vagueness of the term, public interest is claimed generally by governments in matters of state secrecy and confidentiality. It is approximated by comparing expected gains and potential costs or losses associated with a decision, policy, program, or project."
>
> (emphasis supplied)

54. In the context of compulsory amalgamation of two or more companies, the expression "public interest" would mean the welfare of the public or the interest of society as a whole, as contrasted with the "selfish" interest of a group of private individuals. Thus, "public interest" may have regard to the interest of production of goods or services essential to the nation so that they may contribute to the nation's welfare and progress, and in so doing, may also provide much needed employment. "Public interest" in this context would, therefore, mean the combining of resources of two or more companies so as to impact production and consumption of goods and services and employment of persons relatable thereto for the general benefit of the community. Conversely, any action that impedes promotion of industry or obstructs growth which is in national or public interest would run counter to public interest as mentioned in this Section.

55. At this juncture, we must first see whether each of the conditions precedent to the applicability of Section 396 applies to the facts of the present case. Insofar as the Central Government being "satisfied" is

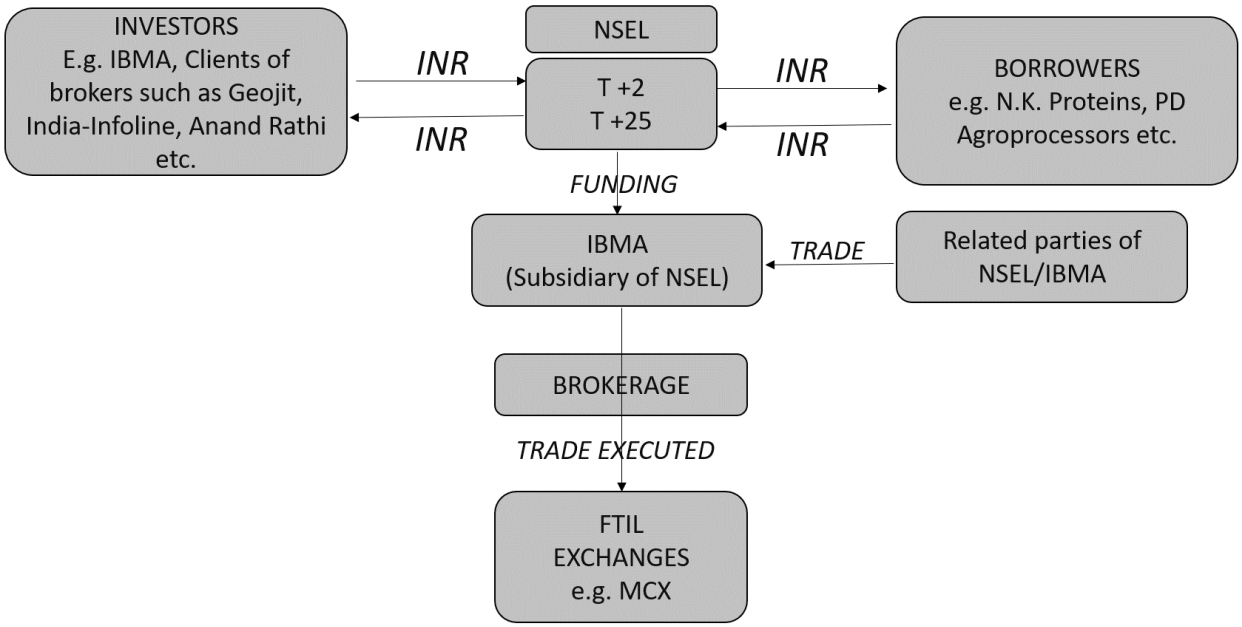
concerned, the following facts which the Central Government has taken into account, based upon the Grant Thornton report and the FMC order dated 17.12.2013, are as follows:

55.1. The Grant Thornton report does indeed begin with a disclaimer, which reads as follows:

> "**4. Limitations**
>
> 4.1. Our findings are based upon the information made available to us and we have not independently verified or validated the information.
>
> 4.2. Our work did not constitute an audit under any accounting standards and the scope of our work was significantly different from that of a statutory audit. Hence it cannot be relied upon to provide the same level of assurance as a statutory audit.
>
> 4.3. Work done by us was as considered necessary at that point of time to reflect the scope of work and rigour required.
>
> **5. Restrictions**
>
> 5.1. Our reports and comments are confidential in nature and not intended for general circulation or publication, nor are they to be quoted or referred to in whole or in part, without our prior consent in each specific instance. Such consent shall not be unreasonably withheld. NSEL and FMC shall have no authority or ability to modify our findings in any manner. We disclaim all responsibility or liability for any costs, damages, losses, liabilities, expenses incurred by anyone as a result of circulation, publication, reproduction or use of our reports contrary to the provisions of this paragraph. Should additional information or documentation become available which impacts upon conclusions reached in our reports, we reserve the right to amend our findings and reporting accordingly. Further, comments in our reports are not intended, nor should they be interpreted to be, legal advice or opinion."

However, the said report in the executive summary states:

> "B. *Executive Summary*
>
> This executive summary is to be read in conjunction with the whole report and should not be treated as a standalone document.
>
> *Financing Business*
>
> 1.1 The NSEL exchange platform was being used to conduct a financing business.
>
> Indian Bullion Market Association ('IBMA') enabled large volumes of trading by a related party on FTIL group exchanges (NSEL and Multi-Commodity Exchange of India Limited ('MCX').)
>
> This is illustrated as per the diagram below:—



> 1.2 Grant Thornton observed that a large volume of NSEL exchange trades were carried out with paired back-to-back contracts. Investors simultaneously entered into a short term buy contract (e.g. T+2 – i.e. 2-day settlement) and a long-term sell contract (e.g. T+25- i.e. 25 day settlement). The contracts were taken by the

same parties at a pre-determined price and always registering a profit on the long-term positions as illustrated below:

Trade Date	***Deal No***	***Buy /Sell***	***Member ID***	***Name of Member***		***Contract Code***	***Sub Broker No.***	***Terminal ID***	***Trade Price***	***Trade Value***
02 April 2012	*87*	*S*	*13790*	*PD AGROPROCESSORS PVT. LTD.*	*DLF002*	*PDY1121 HR2*	*474*	*13791*	*2400.00*	*360,000*
02 April 2012	*87*	*B*	*10570*	*ANAND RATHI COMMODITIES LTD.*	*HNR320*	*PDY1121 HR2*	*232*	*10575*	*2400.00*	*360,000*
02 April 2012	*88*	*S*	*10570*	*ANAND RATHI COMMODITIES LTD.*	*HNR320*	*PY1121H R25*	*232*	*10575*	*2450.70*	*367,605*
02 April 2012	*88*	*B*	*13790*	*PD AGROPROCESSORS PVT. LTD.*	*DLC001*	*PY1121H R25*	*474*	*13791*	*2450.70*	*367,605*

1.3 These long-term contracts (e.g. T+25) were first traded on the NSEL exchange in September 2009. The Board of NSEL ratified the circulars introducing such long-term contracts over a period beginning November 2009.

1.4 Further evidence was obtained with regards the existence of a financing business, such as presentations which stated that a fixed rate of return was guaranteed on investing in certain products on the NSEL exchange.

Several internal (NSEL) presentations were found, upon a review of e-mail databases, setting out a yield (e.g. 16%) as an opportunity for investors for trading in certain products on the NSEL exchange.

An external presentation was also obtained which had been made by a brokerage house (Geojit Comtrade Ltd.) for their clients claiming a fixed return on investments made on the NSEL exchange. Further, this presentation, declared that actual delivery of stocks in such transactions would not be required.

1.5 Grant Thornton also obtained evidence of repeated contraventions of NSEL exchange rules and bye-laws which facilitated such financing transactions to continue and grow in size as below:

Repeated Defaults: As per the NSEL exchange rules a member who does not have sufficient collateral/monies etc. to discharge his obligations would not be allowed to trade further. This rule was overridden on a recurring basis. Further despite repeated defaults members were allowed to trade and increase their expenses. For example, Lotus Refineries had defaulted, as per the Rules of the Exchange, on 198 days between the fifteen-month period of 1 April 2012 and 30 July 2013.

Exemptions from Margin Requirements: Members who were in a default position or whom had exhausted their margin limits on trading were granted an exemption from margin requirements and thus allowed them to increase their exposure by engaging in new trades. More than 1,800 margin limit exemptions were granted between 2009 through to 2013.

Inadequate monitoring of member collateral: NSEL did not carry out any diligence to establish the existence of stock at member managed warehouses, upon which trades were being executed. Grant Thornton carried out a stock verification exercise and found significant shortages vis-à-vis expected collateral.

Related Party Transactions

1.6 IBMA is registered as a client with Karvy Comtrade limited for executing trades on futures commodity exchange like MCX and NCDEX.

SNP Designs Private Limited (SNP) is a client of IBMA and the managing director of SNP is Mrs. Shalini Sinha, the wife of Mr. Anjani Sinha (CEO and MD of NSEL as well as IBMA).

Grant Thornton found evidence of a large volume of trades executed on the MCX exchange on behalf of SNP, through Karvy Comtrade Limited. Since April 2012 the total nominal value/volume traded on MCX is approximately Rs. 40,000 crore.

In spite of heavy losses over the period, trading on behalf of SNP was allowed to continue. No margin money was ever taken from SNP. As at 20 September 2013, IBMA is due to receive Rs. 77 crore on account of losses arising from trades executed on behalf of SNP.

No monies have been received from SNP despite substantial amounts due.

Further, evidence was obtained that Rs. 10 crore was received from Mohan India which was credited to an IBMA Bank account. This was to be adjusted against the SNP receivable balance as per an instruction made by Mr. Anjani Sinha.

1.7. IBMA is a subsidiary of NSEL and has received funding for operational needs on several occasions (including a loan of Rs. 5 crore on 5 August 2013). IBMA is also a member on the NSEL exchange and executes trades on behalf of clients. Margin limit exemptions have been granted to IBMA on a daily basis since February 2010.

Corporate Governance & Risk Management

1.8 While the Bye-laws and Rules of the Exchange mandated the formation of various Committees to effectively manage the operations of the Exchange; the Board failed to constitute 9 out of the 10 such committees. Further, there is no documentary evidence to demonstrate whether the only committee formed (Membership Committee) was ever convened and hence, met its objectives.

1.9 The Board Meeting minutes regularly (eg. 11 June 2008, 15 June 2009, 25 May 2011) stated that the Audit Committee had detailed discussions on the Annual Financial Statements, the Internal Control Systems, reviewing the scope of Internal Audit functions, the performance of the statutory and internal auditors, the scope of work for the internal auditors, the planning of the statutory audit for the current financial year, the payment of audit fees, the observations by the auditors in the draft Auditor Report etc.

Upon review of the corresponding Audit Committee minutes we noted no reference to discussions on Internal Control Systems, reviewing the scope of Internal Audit functions, performance of internal auditors and scope of work for the internal auditors.

Common members of the Board and the Audit Committee were:

Mr. Jignesh Shah
Mr. Joseph Massey
Mr. V. Hariharan
Mr. Shreekant Javalgekar

1.10 The Board Meeting minutes of 31 March 2010 and 11 August 2010 stated that the Company (NSEL) approached Karvy Financial Services Limited (KFSL) to extend credit facilities to a member, specifically N.K. Proteins. Further the Board granted and approved for issue of a guarantee to KFSL, to the extent of Rs. 14 crores, in respect of credit facilities extended to N.K. Proteins.

1.11 Our review of the Information technology identified several independent standalone systems wherein the flow of business transactions and related information between different systems required manual intervention. Given the complexity and nature of trading transaction such systems including warehouse (eWDMS), CNS, Delivery System (EMI) and trading should have been integrated.

Further, these systems did not produce/have any form of MIS operational. All reporting and analysis was done on manual worksheets. Our review of the Board minutes did not indicate any form of MIS reporting or review.

These points collectively indicate significant gaps in IT, Risk & Corporate Governance.

Misutilisation of client monies

1.12 Misutilisation of client monies/settlement fund: As per the rules and bye-laws of the NSEL exchange “Margin deposits received by clearing members from their constituent members and clients in any forms shall be accounted for and maintained separately in segregated accounts and shall be used solely for the benefit of the respective constituent members’ and client position.”

Grant Thornton found evidence (including e-mails) that client monies/settlement fund, was used regularly for fulfilling the obligations of defaulting members.

Further, NSEL utilised client monies/settlement fund for its own business purposes on a regular basis. For

example, on 28 March, 2013, Rs. 236.5 crore was withdrawn from the Settlement Fund in order to fund NSEL's own business overdraft account.

There was a running deficit in the client monies/settlement fund balance from April 2012 to June 2013. The finance team of FTIL had raised this as an area of concern on several occasions.

Misrepresentations to the Regulator

1.13 Regulatory Contraventions:

As per a Gazette Notification issued on 5 June 2007 by the Ministry of Consumer Affairs, the Government of India under Section 27 of the Forward Contracts (Regulation) Act, 1952 ("FCRA") exempted all forward contracts of one day duration for the sale and purchase of commodities traded on NSEL from the operations of the said Act. Grant Thornton's review of the type of trades executed on the NSEL exchange indicates contravention to the exemption conditions granted.

During the period January 2011 to July 2013, FMC sought several clarifications from NSEL on a number of complaints received from the public alleging forward trading and running a financing scheme. All these allegations were refuted by NSEL. Our analysis of such trades indicates misrepresentation by NSEL to FMC on several occasions."

The report then goes on to say that there was no documentation in relation to warehouse activities for long term trades indicating that such contracts were not secured by warehouse stocks. The warehouses were customer managed warehouses and the underlying collateral were not in custody of NSEL. NSEL did not have control over these warehouses and Grant Thornton was denied access to number of warehouses. The Warehouse Development and Regulatory

Authority had in fact rejected NSEL's application for registration of its warehouses way back on 16.05.2011. Notwithstanding such rejection, NSEL's website represented that its warehouses were registered with the Authority. No verification or due diligence was ever undertaken by NSEL to ensure compliance by its members of the conditions outlined in its rules and byelaws even though in terms of NSEL byelaws, warehouse receipt issued by NSEL were meant to evidence a commodity being held in an approved warehouse. NSEL did not insist upon deposit of commodities in the warehouses prior to executing sale transactions. Instead NSEL resorted to issuing Delivery Allocation Reports (DAR) representing to genuine investors that each transaction was delivery based and backed at the time of sale by the required quantity of commodities in its warehouses.

55.2. The observations and conclusions of the FMC order dated 17.12.2013, based largely on this expert report, read as follows:

> "**15. Summary Observations and Conclusion:-** After having accorded due consideration to all the objections and arguments raised by the noticees vide their written submission as well as oral presentations through their counsel, we now proceed to conclude our observations by taking a final view on the status of the four noticees as 'fit and proper persons' in the succeeding paragraphs.
>
> 15.1. **Noticee No. 1:- Financial Technologies (India) Limited (FTIL):** We have discussed the equity structure of NSEL, which is wholly owned by FTIL. We have also

pointed out that Shri Jignesh Shah, Chairman-cum-Managing Director of FTIL has been a Director on the Board and also functioning as Vice-Chairman and a key management person of NSEL since its inception. Similarly, Shri Joseph Massey and Shri Shreekant Javalgekar have been Directors of the said company from its very beginning till the settlement crisis at NSEL first came to light in July, 2013. The facts establishing the fraud involving a settlement default over Rs. 5,500 crores at NSEL have been discussed at length in the SCNs issued to the noticees as well as reiterated, albeit illustratively by us at Para No. 14.7 of this Order. The responsibility of FTIL as the holding company possessing absolute control over the governance of NSEL has also been highlighted. The control of FTIL over NSEL becomes further crystallized from the responses given by M/s. Grant Thornton before the Commission on 03.12.2013 stating that Shri Jignesh Shah, Mr. Joseph Massey and a host of other officials of FTIL reviewed the forensic audit report and it was only after obtaining their clearance, the forensic auditor finalised its report.

15.1.1. The violation of conditions prescribed in the exemption notification, trading in paired contracts to generate assured financial returns under the garb of commodity trading, admission of members who were thinly capitalised having poor net worth and giving margin exemptions to those who were repeatedly defaulting in settling their dues, poor warehousing facilities with no or inadequate stocks, no risk management practices followed, non-provision of funds in SGF, consciously appointing Shri Mukesh P. Shah as statutory auditors for F.Y. 2012-13 who was related to Shri Jignesh Shah, and apparent complicity with the defaulters to defraud the investors, etc., lead to an inescapable conclusion that a huge fraud was perpetrated by NSEL while having the presence of two Board members of FTIL on the Board of NSEL, one of whom was the Vice-Chairman of the company.

15.1.2. The facts of the case and the manner in which the business affairs of NSEL were conducted leaves no

doubt in our minds that FTIL, notwithstanding its contentions that it was ignorant of the affairs and conduct of NSEL, exerted a dominant influence on the management, and directed, controlled and supervised the governance of NSEL. In the face of a fraud of such a magnitude involving settlement crises of Rs. 5,500 crores owed to over 13,000 sellers/investors on the trading platform of NSEL, FTIL, cannot seek to take refuge behind the corporate veil so as to unjustifiably isolate itself from the fraudulent actions that took place at NSEL resulting in such a huge payment crisis.

15.1.3. FTIL has its principal business of development of software which has become the technology platform for almost the entire industry engaged in broking in shares and securities, commodities, foreign exchange etc. As has been demonstrated by FTIL in their written submission, FTIL has floated a number of regulated exchanges – both for securities and commodities derivatives – in India as well as abroad. NSEL was incorporated to provide a trading platform of commodity spot exchange on a pan-India basis for the purpose of which apparently it sought and was granted exemption from the operation of the FCRA, 1952. Since the objective of the NSEL was promoting spot trading in commodities on an electronic platform, its business model did not contemplate venturing into trading in forward contracts. FTIL had already promoted MCX, a regulated exchange under FCRA, 1952, for the purpose of trading in forward contracts. Therefore, having secured an exemption from the purview of FCRA, 1952 on the ground that it was intended to promote spot trading, NSEL was not authorised to allow trading in forward contracts through the scheme of paired contracts, thereby defying conditions stipulated in the exemption notification granted to it. The motive behind allowing trading in forward contracts on the NSEL platform in a circuitous manner on NSEL which was neither recognized nor registered under FCRA, 1952 indicates *mala fide* intention on the part of the promoter of FTIL to use the trading platform of its subsidiary company for illicit gains away from the eyes of

Regulator. The fact that FTIL promoted NSEL sought exemption from FCRA, 1952 provisions even before they had started any trading or operation, points to their intention from the outset. In this manner, it misinterpreted the conditions stipulated in the exemption notification in collusion with a handful of members, which ultimately culminated in a massive fraud involving Rs. 5,500 crores, which has the potential effect of eroding trust and confidence in exchanges and financial markets.

15.1.4. Keeping in view the foregoing observations and the facts which reveal misconduct, lack of integrity and unfair practices on the part of FTIL in planning, directing and controlling the activities of its subsidiary company, NSEL, we conclude that FTIL, as the anchor investor in the Multi-Commodity Exchange Ltd. (MCX) does not carry a good reputation and character, record of fairness, integrity or honesty to continue to be a shareholder of the aforesaid regulated exchange. **Therefore, in the public interest and in the interest of the Commodities Derivatives Market which is regulated under FCRA, 1952, the Commission holds that Financial Technologies (India) Ltd. (FTIL) is not a 'fit and proper person' to continue to be a shareholder of 2% or more of the paid-up equity capital of MCX as prescribed under the guidelines issued by the Government of India for capital structure of commodity exchanges post 5-years of operation.** It is further ordered that neither FTIL, nor any company/entity controlled by it, either directly or indirectly, shall hold any shares in any association/Exchange recognised by the Government or registered by the FMC in excess of the threshold limit of the total paid-up equity capital of such Association/Exchange as prescribed under the commodity exchange guidelines and post 5-year guidelines."

(emphasis in original)

Based on the Grant Thornton report and the FMC order, the draft amalgamation order dated 21.10.2014 then relied on the same facts,

as did the final assessment order. The final amalgamation order also refers to an investigation under Section 209A into the affairs of NSEL which led to infractions of Sections 211, 217 and 292A of the Companies Act. These are compoundable offences which have, in fact, been compounded by orders dated 03.03.2016 and 31.05.2016 by the concerned authority.

55.3. We have seen that neither FTIL nor NSEL has denied the fact that paired contracts in commodities were going on, and by April to July, 2013, 99% (and excluding E-series contracts), at least 46% of the turnover of NSEL was made up of such paired contracts. There is no doubt that such paired contracts were, in fact, financing transactions which were distinct from sale and purchase transactions in commodities and were, thus, in breach of both the exemptions granted to NSEL, and the FCRA. We have also seen that NSEL throughout kept representing that it was, in fact, a commodity exchange dealing with spot deliveries. Apart from the Grant Thornton report and the FMC order, we have also seen that Shri Jignesh Shah, on 10.07.2013, made representations to the DCA and the FMC, in which he stated that NSEL had full stock as collateral; 10-20% of open position as margin money; and that the stock currently held in NSEL's 120 warehouses was valued at INR 6000 crore, all of which turned out to be incorrect.

Further, there is no doubt whatsoever that in July, 2013, as a result of NSEL stopping trading on its exchange, a payment crisis of approximately INR 5600 crore arose. The further question that remains is whether, given these facts, the conditions precedent for the applicability of Section 396 were followed.

56. When it comes to whether the Central Government's satisfaction as to whether it was "essential" to amalgamate the aforesaid companies, what must be borne in mind is that NSEL had itself offered a settlement scheme to pay back the persons who have allegedly been duped. It was found that this scheme could not really take off, as a result of which, large amounts continued to be owed to such persons. That this was the real concern of the FMC is clear from a letter dated 18.08.2014 addressed by the FMC to the Secretary, Ministry of Corporate Affairs. This letter states:

> "xxx xxx xxx
>
> 2. As apprised earlier, consequent to the suspension of trading and a huge settlement default that took place at NSEL on 31.07.2007, the Government of India, Ministry of Consumer Affairs, Food & Public Distribution, Department of Consumer Affairs (DCA) vide its notification dated 6th August, 2013 (copy enclosed as Annexure II) inter-alia provided that settlement of all outstanding one day forward contract at NSEL shall be done under the supervision of FMC. In exercise of this supervisory role, the Commission has been continuously taking all possible steps and has been regularly pursuing

with NSEL to expedite the recovery proceedings against the defaulters at its platform. To ensure better monitoring of NSEL's compliance the Commission had vide No. 8/1/2013 (1)-MD-1(1)(C)/Settlement (Vol.-IV) dated 29th November, 2013 (copy enclosed as Annexure III) constituted a Monitoring & Auction Committee (MAC) comprising the representatives of various members associations and investors bodies to assist and advise the Commission on matters pertaining to the Commission's supervisory role over the settlement of outstanding contracts at NSEL.

3. It is observed that even after one year's incessant efforts and in spite of FMC's active role in supervising the settlement of contracts, the settlement plan could not result in making any substantial payment to the investors as the process of recovery of dues by NSEL from the defaulting members is very slow. It is submitted that, it is only the NSEL, which has the responsibility to take all possible coercive measures as per their rules/bye-laws and other laws of the land, to ensure that the outstanding dues of all investors are settled. However as on date, NSEL has been able to make a payment of only Rs. 538.56 crores to its members as against the payment dues of approximately Rs. 5500 crores. This amount also includes an amount of Rs. 179.26 crores borrowed by NSEL from its holding company, FTIL which was distributed to small participants. The representatives of members associations and investor bodies on the MAC in their meeting with the Commission have represented the NSEL has lost its credibility as an institution. Further the employee attrition in NSEL in the recent months has been extremely high and it is learnt that the staff strength of NSEL has come down considerably, adversely affecting the recovery process. As per the information received from NSEL, the total employee count on NSEL rolls was 193 as on 31.07.2013 (when NSEL had suspended trading in one day forward contracts) which came down to 33 on 31.07.2014. The morale of the employees at NSEL is also very low. NSEL is also confronted with a number of cases against it, which are pending in the High Courts

and MPID Court relating to its failure to make payment to the investors. The company is hardly left with any financial resources to meet even legal expenses apart from meeting staff salaries and other expenses related to recovery process. The members of the Monitoring & Auction Committee have expressed their views that with the loss of credibility, weak Organizational structure, depletion of man-power strength and lack of financial resources, NSEL has become totally ineffective in pursuing the recovery of the defaulted amounts from the defaulter members.

4. It may be noted that NSEL is a subsidiary of Financial Technologies India Ltd. (FTIL) which holds 99.99% of the shares of NSEL. Hence, for all practical purposes NSEL is a wholly owned subsidiary of FTIL and therefore it is the primary responsibility of the parent company, i.e. FTIL to own complete responsibility for the affairs of its subsidiary company. In this regard attention is drawn to the order of the Commission No. 4/5/2013-MKT-I/B dated 17th December, 2013 (copy enclosed as Annexure IV) in the matter of "Fit and Proper Person" status of M/s FTIL (another shareholder and promoter of MCX) and in the matter of Shri Jignesh Shah & Shri Joseph Massey ex-Directors & Shri Shreekant Javalgekar ex-MD and CEO of MCX. Some of the important highlights of the said order pertaining to FTIL are as below:

(i) In para 14.2.1 of the order it is inter-alia mentioned that NSEL by virtue of being a separate legal entity cannot be said to be independent from the control of the holding/parent company i.e. FTIL which holds 99.99% of its share capital.

(ii) In para 14.5.2 it is inter-alia mentioned that since FTIL is effectively the only shareholder of NSEL, the constitution of the Board of Directors of NSEL is entirely under its control. FTIL through the Board of Directors of NSEL constituted by it possesses effectual and absolute control over its subsidiary company i.e. NSEL. Such control is further amplified and

accomplished by the fact that Shri Jignesh Shah, the promoter and Chairman-cum-Managing Director of FTIL has been on the Board of NSEL and functioning as Vice-Chairman of the Company since its inception. Shri Joseph Massey was also a common Director both on the Board of FTIL and NSEL, while Shri Shreekant Javalgekar continued to be a Director of NSEL till he resigned from the post in July 2013;

(iii) In para 14.5.3 of the order it is inter-alia mentioned that it is on record that all the minutes of Board meetings of NSEL were regularly tabled at the Board meetings of FTIL. FTIL kept itself apprised about the affairs of NSEL and also approved/ratified the actions of NSEL in its Board meetings on a regular basis;

(iv) In para 14.9.1 of the order it is inter-alia mentioned that it is undisputed that NSEL was an Exchange in which FTIL had ownership interest to the extent of 99.9998% leaving a negligible 0.0002% stake to NAFED. The Articles of Association of NSEL confers authority to its shareholders to appoint Directors. As the single largest shareholder, it is FTIL which has nominated all the directors on the NSEL board. As a wholly-owned subsidiary, NSEL is completely under the control of FTIL, including financial control over the affairs of NSEL. FTIL, which had the responsibility of managing the affairs of NSEL, cannot claim to be unaware of the wrong-doing and fraud committed by the management of NSEL.

(v) In para 14.10.06 of the order it is inter-alia mentioned that FTIL cannot shy away from its role and duty as a parent company to take reasonable care and exercise prudence in management and governance of the subsidiary company.

(vi) In para 14.10.8 of the order it is inter-alia mentioned that FTIL has not furnished any

explanation as to what steps have been taken by NSEL or by it as a parent company to honour the commitment of assuring safety and risk-free trading to the members and clients who have traded on their platform purely on the basis of an explicit assurance that the Exchange shall step into the shoes of counter parties should there be any default by any participant.

(vii) In para 15.1.3 of the order it is inter-alia mentioned that FTIL has its principal business of development of software which has become the technology platform for almost the entire industry engaged in broking in shares and securities, commodities, foreign exchange etc. The motive behind allowing trading in forward contracts on the NSEL platform in a circuitous manner on NSEL which was neither recognized nor registered under FCRA, 1952 indicates mala fide intention on the part of the promoter of FTIL to use the trading platform of its subsidiary company for illicit gains away from the eyes of Regulator.

5. The aforesaid facts would clearly establish that the Board of FTIL and its promoters under the leadership of Shri Jignesh Shah have been actively controlling and directing the affairs of NSEL and it is due to the poor governance and irregularities perpetrated in to the affairs of NSEL by FTIL and its promoters that the defaulting members defrauded the exchange to the extent of Rs. 5,500 crores thereby causing huge financial loss to more than 13,000 investors. It is submitted that the aforesaid order dated 17th December, 2013 passed by the Commission is based on tangible facts on the role of FTIL in the affairs of NSEL, mustered by the Commission on its own and also the facts revealed by the forensic auditor M/s. Grant Thornton who were engaged by NSEL to conduct a forensic audit into the affairs of NSEL post the settlement crisis. It may be noted the Hon'ble Bombay High Court has also refused to grant any interim relief to FTIL and three other

individuals in respect of the aforesaid order dated 17th December, 2013 passed by the Commission declaring FTIL, Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar as not fit and proper persons to be shareholders or a Director in any of the recognized commodity exchanges. FTIL and other three individuals have so far not challenged the above interim order of the Hon'ble High Court.

6. It is also submitted that the Working Group constituted by the Central Government under the Chairmanship of Deputy Governor, Reserve Bank of India to examine into the systematic risk arising in consequence of the NSEL settlement debacle, have inter alia recommended that the ownership, governance and management structure at FTIL and the exchanges promoted by FTIL need to be assessed and the possibility of bringing in an institutionalized framework and approach to these aspects explored.

7. It may also be noted here that pursuant to the criminal proceedings and arrest of Shri Jignesh Shah, Chairman-cum-Managing Director of FTIL who was also the Vice-Chairman of NSEL, the EOW of Mumbai Police, has since filed a chargesheet against Shri Jignesh Shah under various sections of Indian Penal Code and also the Maharashtra Protection of Interest of Depositors (MPID) Act, 1999, before the Hon'ble Sessions Judge, Special Court under MPID Act, Mumbai which vindicates the stand already taken by the Commission in its order dated 17th December, 2013 pertaining to the role and responsibility of FTIL as a parent company in the affairs of its wholly owned subsidiary i.e. NSEL.

8. The aforesaid submissions would make it clear that NSEL as a corporate entity has now been rendered bereft of any credibility and now seems financially and physically incapable of effecting any substantial recovery from the defaulting members, notwithstanding all the legal and other measures taken by it against them under the instructions/supervision of the Commission. Similarly, the Board and management of FTIL, by their very conduct in managing the affairs of NSEL and continuous effort to distance themselves from their responsibility

towards NSEL after the settlement default, have lost their credibility as a responsive and responsible holding company.

9. Keeping the aforesaid emergency situation in view, the Commission is of the view that time has come for the Ministry of Corporate Affairs to consider:

(i) merging/amalgamating NSEL with FTIL in public interest so that the human/financial resources of FTIL are also directed towards facilitating speedy recovery of dues from the defaulters at NSEL and FTIL takes responsibility to resolve the payment crisis at NSEL at the earliest.

(ii) Further, it is suggested that together with merger/amalgamation of NSEL with FTIL, taking over of the management of FTIL may also be considered so that the affairs of FTIL can be managed in a professional way by bringing in an institutionalized framework as recommended by Working Group appointed by Government of India.

xxx xxx xxx"

(emphasis supplied)

This letter would show that the immediate reason for amalgamation, according to the FMC, and which was faithfully carried out by Government, is that NSEL, as a corporate entity, seems financially and physically incapable of effecting any substantial recovery from defaulting members. This was the "emergency situation" according to the FMC, which should lead to an order of amalgamation of the holding and subsidiary companies so that the holding company's financial resources could be used to pursue proceedings by which

monies owed to the alleged duped investors/traders could be recovered.

56.1. What is important to note is that by the time the final order of amalgamation was passed, i.e., on 12.02.2016, the final order itself records:

> "**8.1. Economic Offences Wing, Mumbai:**
>
> - Total amount due and recoverable from 24 defaulters is Rs. 5689.95 crores.
> - Injunctions against assets of defaulters worth Rs. 4400.10 crore have been obtained.
> - Decrees worth Rs. 1233.02 crore have been obtained against 5 defaulters.
> - Assets worth Rs. 5444.31 crore belonging to the defaulters have been attached of which assets worth Rs. 4654.62 crore have been published in Gazette under the MPID Act for liquidation under the supervision of MPID Court and balance assets worth Rs. 789.69 crore have been attached/secured for attachment by the EOW:
> - Assets worth Rs. 885.32 crore belonging to the directors and employees of NSEL have been attached out of which assets worth Rs. 882.32 crores have already been published in Gazette under MPID Act for liquidation under the supervision of MPID Court and balance assets worth Rs. 3 crore have been attached/secured for attachment by the EOW;
> - MPID Court has already issued notices u/s 4 & 5 of the MPID Act to the persons whose assets have been attached as above. Thus, the process of liquidation of the attached assets has started.
> - Bombay High Court has appointed a 3-

member committee headed by Mr. Justice (Retd.) V.C. Daga and 2 experts in finance and law to recover and monetize the assets of the defaulters.

- Rs.558.83 crores have been recovered so far, out of which Rs. 379.83 crore have been received/recovered from the defaulters and Rs. 179 crore were disbursed by NSEL to small traders/investors.

8.2. Enforcement Directorate:

- ED has traced proceeds of crime amounting to Rs. 3973.83 crore to the 25 defaulters;
- ED has attached assets worth Rs. 837.01 crore belonging to 12 defaulters;
- As per the recent amendment in the PMLA, the assets attached by ED can be used for restitution to the victims.

8.3. The above status indicates that the said enforcement agencies are working as per their mandate…….”

56.2. What concerned the FMC in August 2014 has, by the date of the final amalgamation order, been largely redressed without amalgamation. The “emergency situation” of 2013 which, even according to the Central Government, required the emergent step of compulsory amalgamation has, by the time of the passing of the Central Government order, disappeared. Thus, the raison d’être for applying Section 396 of the Companies Act has, by the passage of time, itself disappeared. In fact, as on today, decrees/awards worth INR 3365 crore have been obtained against the defaulters, with INR 835.88 crore crystallised by the committee set up by the High Court,

pending acceptance by the High Court, even without using the financial resources of FTIL as an amalgamated company. What is, therefore, important to note is that what was emergent, and therefore, essential, even according to the FMC and the Government in 2013-2014, has been largely redressed in 2016, by the time the amalgamation order was made. Also, the Central Government order does not apply its mind to the essentiality aspect of Section 396 at all. In fact, in several places, it refers to “essential public interest” as if “essential” goes with “public interest” instead of being a separate and distinct condition precedent to the exercise of power under Section 396. On facts, therefore, it is clear that the essentiality test, which is the condition precedent to the applicable to Section 396, cannot be said to have been satisfied.

57. During the course of proceedings before the Division Bench of the Bombay High Court, FTIL tendered an affidavit dated 04.07.2017, to place on record its resolution dated 28.03.2016 to infuse a sum of upto INR 50 crore for each of the financial years 2016-2017 to 2018-2019 to support NSEL to recover dues from defaulters, defend various cases, and continue taking necessary legal action against various parties to recover amounts from defaulters. The Division Bench refers to this affidavit as follows:

"**293]** At the stage, when the final hearing in these petitions had considerably advanced, FTIL, tendered an affidavit dated 4th July 2017 to place on record its resolution dated 28th March 2016 to infuse a sum up to Rs. 50 crores for each of the financial years, i.e., FY 2016-17 to FY 2018-19, to support NSEL to recover dues from defaulters; to defend various legal cases; to continue taking necessary legal actions against various parties to recover amounts from defaulters; and for working capital. The affidavit states that such resolution was passed and such finances are proposed to be infused at the request of NSEL.

294] The affidavit dated 4th July 2017 also confirms that the activities of NSEL have come to *a grinding halt*, though, the affidavit purports to blame the FMC for such a situation. The affidavit also states that up to now FTIL has infused approximately Rs. 109 crores with NSEL, mainly to prosecute and defend legal proceedings. There is reference to NSEL having obtained decrees worth more than Rs. 1200 crores and injunctions against assets of defaulters valued at Rs. 5444.31 crores. The affidavit further states that FTIL is committed to funding NSEL for purposes of recovery from defaulters since the occurrence of payment crisis on the exchange platform of NSEL.

295] If the contention of Mr. Chinoy to the effect that there is absolutely no problem in the functioning of NSEL or that NSEL has the necessary wherewithal, both financial as well as infrastructural, to effect recoveries from the defaulters, is to be accepted, then, there was no reason to rely upon contribution from FTIL, made or proposed to be made at a belated stage. The FTIL resolution dated 28th March 2016, far from affording any cause to interfere with the impugned order, in fact, lends support to the reasoning in the impugned order that the NSEL, on its own, lacks financial as well as infrastructural capacity to affect any recoveries from the defaulters. The affidavit dated 4th July 2017 and the resolution dated 28th March 2016 is also indicative of the business realities of the situation, which is incidentally yet another ground in the impugned order."

(emphasis in original)

58. The High Court comment on the aforesaid affidavit is not correct. The affidavit proceeds on the footing that since the activities of NSEL have come to a grinding halt, FTIL would help NSEL to effect recoveries from defaulters. The affidavit nowhere states that there is no problem in the functioning of NSEL, or that NSEL has or does not have the necessary wherewithal to effect recovery from defaulters. Even in the hearing before us, FTIL has submitted an affidavit-cum-undertaking dated 11.04.2019, stating that it will continue to infuse funds into NSEL so that recovery of dues from defaulters does not, in any manner, get stymied. We take this affidavit and undertaking on record, and hold FTIL to this undertaking made before this Court.

59. When it comes to "public interest" as opposed to the "private interest" of investors/traders, who have not been paid, the amalgamation order dated 12.02.2016 makes interesting reading. The satisfaction as to public interest is stated in the very beginning of the order as follows:

> "Whereas the Central Government is satisfied that to leverage combined assets, capital and reserves, achieve economy of scale, efficient administration, gainful settlement of rights and liabilities of stakeholders and creditors and to consolidate businesses, ensure coordination in policy, it is essential in the public interest……."

What is stated in the opening is repeated in paragraph 2.14.2 as follows:

> "2.14.2 The Central Government also carefully considered the proposal received from FMC and DEA and was of the considered opinion that to leverage combined assets, capital and reserves for efficient administration and satisfactory settlement of rights and liabilities of stakeholders and creditors of NSEL, it would be in essential public interest to amalgamate NSEL with FTIL."

It will be seen that all the expressions used in relation to "public interest" have relation only to the businesses of the two companies that are sought to be amalgamated. What is important to note is that there is no interest of the general public as opposed to the businesses of the two companies that are referred to. It is important to notice that the leveraging of combined assets, capital, and reserves is only to settle liabilities of certain stakeholders and creditors when the order is read as a whole, and given the fact that the businesses of the two companies were completely different. So far as achieving economy of scale and efficient administration is concerned, it is difficult to see how this would apply to the fact situation in this case where NSEL is admittedly a company which has stopped functioning as a commodities exchange at least with effect from July, 2013 with no hope of any revival. Thus, the consolidation of businesses spoken

about does not exist as a matter of fact, as NSEL's business has come to a grinding halt, as has been observed by the FMC and the Central Government itself. Each one of these expressions, when read with the rest of the order, therefore, only shows that the sole object of the amalgamation order is very far from the high-sounding phrases used in the opening, and is really only to effect speedy recovery of dues of INR 5600 crore, which has been referred to in the letter of the FMC to the Secretary, Ministry of Corporate Affairs, dated 18.08.2014. This would be clear from a reading, in particular, of two paragraphs of the order, namely, paragraphs 2.13.2 and 2.13.3, which read as follows:

> "2.13.2. Thus, it would be observed from above that NSEL is not having the resources, financial or human, or the organizational capability to successfully recover the dues to the investors pending for over a year. Further, NSEL is not left with any viable, sustainable business while FTIL has the necessary resources to facilitate speedy recovery of dues.
>
> 2.13.3. In the above background, a proposal had been received from FMC, vide letter dated 18-08-2014, proposing the merger of NSEL with FTIL by the Central Government under the provisions of Section 396 of the Companies Act, 1956. The proposal has been supported by the Department of Economic Affairs (DEA), Ministry of Finance, FMC has proposed the merger/amalgamation of NSEL with FTIL in essential public interest so that the human/financial resources of FTIL are also directed towards facilitating speedy recovery of dues from the defaulters at NSEL and the FTIL takes responsibility to resolve the payment crisis at NSEL at the earliest."

59.1. However, the Central Government supported this order on the ground that it is made in public interest essentially on three grounds, which are repeatedly referred to by the impugned judgment. The three grounds as stated by the impugned judgment are as follows:

> "**269.** …… (a) Restoring/safeguarding public confidence in forward contracts and exchanges which are an integral and essential part of Indian economy and financial system, by consolidating the businesses of NSEL and FTIL; (b) Giving effect to business realities of the case by consolidating the businesses of FTIL and NSEL and preventing FTIL from distancing itself from NSEL, which is, even otherwise, its *alter ego; and* (c) Facilitating NSEL in recovering dues from defaulters by pooling human and financial resources of FTIL and NSEL. Further, we are also satisfied that each of these three grounds constitute a facet of *public interest* in the context of the provisions in Section 396. ……"

59.2. It is important to note that the first and second grounds mentioned by the High Court are not contained in the draft order of amalgamation. Had they been so contained, objections and suggestions would have been made by all stakeholders, which the Central Government would then have been bound to consider before passing the final order. However, it was argued on behalf of the respondents that the first and second grounds are, in reality, inferences drawn from facts which are already stated in the order and these inferences do not need to be stated in the draft order. We are

afraid that this argument is incorrect inasmuch as grounds contained in reasons (a) and (b) are important grounds which have a vital bearing on the amalgamation in question. If these grounds were contained in the draft order, there is no doubt that the shareholders and creditors of FTIL, and FTIL itself would have had an opportunity to comment on the same. For example, the “business realities” of the case are facts known to FTIL; and NSEL, being FTIL’s alter ego, is the subject matter of dispute in various suits that have been filed and are pending adjudication. FTIL could have responded giving reasons as to why NSEL is not its alter ego. Also, whether the amalgamation is, in fact, to restore or safeguard public confidence in forward contracts and exchanges is a subject matter on which FTIL, its shareholders and creditors, could have commented. Equally, whether NSEL’s exchange was an essential and integral part of the Indian economy and financial system, and whether this defunct business could be consolidated so as to impact the economy are all matters for comment by FTIL and its shareholders and creditors. For all these reasons, we cannot accede to the respondents’ arguments on this score. On this ground alone, even assuming that these two grounds obtained and can be culled out from the final order, not being contained in the draft order, the said

grounds would be in breach of Section 396(3) and (4), and therefore, cannot be looked at to support the order.

59.3. It is important to note that grounds (a) and (b) are both culled out in answer to objections raised by FTIL. The precise objection raised and the answer given are quoted hereinbelow:

> "7.2.1. ***FTIL has challenged the background and reasons for the amalgamation as the power under section 396 of the Act has been used only in case of Government companies alone.*** This argument does not derogate from the scope of the statutory provisions. The statutory provisions of section 396 of the Act are being invoked in essential public interest to safeguard the interest of all stakeholders in the captioned company. The present status and composition of the Boards of FTIL and NSEL have been noted. However, the fact that the Boards had not acted with an independent mind to collect information and put the system under a robust technology is borne out of the simple fact that the Show Cause Notice dated 27-04-2012 issued by the Department of Consumer Affairs based on analysis of trade data by the then Forward Market Commission had given an alarming picture of the state of affairs of NSEL. The public interest driving the merger are set out in the business realities of the case, it is noted from the facts of the case and the recommendations of FMC as well as its order dated 17-12-2013 which throw ample light to the grave shattering of the public confidence and the purpose of establishing commodity exchange has been defeated."
>
> xxx xxx xxx
>
> "7.2.6. ***FTIL and NSEL have distinct and separate objects and nature of operations and completely disparate and unconnected objects, and hence there is no synergy, efficient administration, consolidation***

> ***of business or co-ordination in policy to be gained by the forced amalgamation***; the argument runs contrary to the concept of merger which essentially means that two or more separate entities are getting merged to achieve the objectives of amalgamation. In the instant case, amalgamation is targeted to achieve its stated objects, essentially in public interest. By all intents and purposes, the way both the companies were being managed, owned and controlled, NSEL is the alter ego of FTIL and thus, the two companies have been practically one entity. All stakeholders were also looking at them as one entity. The amalgamation u/s. 396 of the Act only formalizes this practical reality in essential public interest."
>
> xxx xxx xxx
>
> "7.2.8. ***The FTIL has questioned the jurisdiction of the Central Government to decide on the question of fraud and claimed that it has to be proved beyond reasonable doubt by adducing necessary particulars***; the Central Government is invoking section 396 of the Act in essential public interest for the merger of NSEL, which is an almost wholly-owned subsidiary of FTIL. The merger is not an adjudication on the alleged fraud. The merger is targeted to achieve its stated objectives for long term sustainability in the best interest of the stakeholders."
>
> (emphasis in original)

It will be noticed that the objection raised in paragraph 7.2.1 is that Section 396 can be used in the case of Government companies alone, whereas the answer given is that this cannot be so, given the business realities of the case and the FMC order of 17.12.2013 "which throw ample light to the grave shattering of public confidence and the purpose of establishing Commodity Exchange has been defeated". First and foremost, what is important to notice is that the "business

realities" of the case are what is contained in "the recommendations of the FMC". We have seen that these recommendations are in the form of a letter dated 18.08.2014, in which the "business reality" is the fact that dues of INR 5600 crore have to be paid, and that NSEL does not have the wherewithal to do so. Thus, its parent company's financial resources ought to be used to effect such payment. This "business reality", therefore, speaks only of the private interest of the investors/traders who have been allegedly duped (which fact will only be established in suits filed by them in 2014), and nothing beyond (which would show some vestige of public interest). Equally, the grave shattering of public confidence and purpose of establishing commodity exchanges having been defeated, according to the Central Government, is a gloss on the FMC order dated 17.12.2013. If this were so, one would have expected a resuscitation or revival of the commodities exchange of NSEL, which could have been achieved by takeover of its management. It is difficult to imagine that grave shattering of public confidence by the permanent shutting down of the commodities exchange of the NSEL would be remedied only by facilitating the paying of dues to certain allegedly duped investors/traders, which fact will be proved or disproved in suits filed by them which are pending adjudication in the Bombay High Court. In

any case, this reason is wholly irrelevant as an answer to the objection raised by FTIL which, as we have seen, is an objection stating that the Section applies to Government companies alone. Also, had FTIL made no such objection, no such answer would have been forthcoming. As far as paragraphs 7.2.6 and 7.2.8 of the order are concerned, what is admitted in the order itself, is that there is no “adjudication” on the “fraud” in the facts of the present case, and thus, not an exercise of lifting of the corporate veil of the pre-amalgamation companies. The amalgamation order contradicts itself by then stating that NSEL is the alter ego of FTIL, and thus, the two companies are practically one entity. In any event, these paragraphs do not indicate as to how the ‘alter ego’ argument impacts public interest. For all these reasons, therefore, neither reason (a) nor reason (b) ought to detain us any further. Reason (c) is, therefore, the only reason that really remains, as is contained in the letter of 18.08.2014 by the FMC to the Central Government. We have already seen that this reason, by itself, is the protection of the private interest of a group of investors/traders, as distinct from public interest.

59.4. It is important to note that under Section 396(4)(b), the Central Government may, after considering suggestions and objections from the stakeholders mentioned, make modifications in the draft order as

may seem to it desirable in the light of such suggestions and objections. No modification has been made in the body of the Central Government order as finally made. If the Central Government had actually considered that each of these three reasons impact public interest, it would have explicitly said so after suggestions and objections were made by the various stakeholders. The fact that the Central Government has not amended the body of the final order is of great significance – it is only the original reasons given in the draft order that continue as such in the final order which, as we have seen, are not in furtherance of public interest at all. Reasons (a) and (b), part of which is culled out from answers to objections and suggestions given in the final order, is only given separately by the Central Government after the amalgamation order to show that the principles of natural justice as laid down by sub-section (4) of Section 396 have, in fact, been followed. This becomes clear from paragraphs 6.3 and 7 of the final order, which read as follows:

> "**6.3.** The Central Government received in writing and through email various objections / suggestions from various classes of stakeholders including the shareholders, creditors, and all other interested parties claiming that monies are recoverable from the proceedings arising out of the business of the dissolved company.
>
> **7.** Dealing with objections, suggestions and submissions of FTIL, NSEL and other parties – The

> Parties herein have made various objections, suggestions and submissions on the proposed amalgamation u/s. 396 of the Act on the order dated 21-10-2014 in Draft form issued by the Central Government. The said objections, suggestions and submissions were made during the course of hearing and written submissions (physically and electronically) received by the Central Government on various dates. The said objections, suggestions and submissions made by each of the parties are dealt in the manner herein under."

59.5. So far, we have gone by the Central Government order as it stands. The Bombay High Court, in stating reasons (a), (b), and (c) as grounds of public interest, has gone much further than even the answer given to the objections that are contained in the order itself. "Restoring/safeguarding public confidence in forward contracts and exchanges, which are an integral and essential part of the Indian economy and financial system, by consolidating the businesses of NSEL and FTIL," is not contained in the answer given to objections in the order. First and foremost, restoring public confidence is no part of the order. What is mentioned is only the fact that public confidence has been shattered, as is reflected by the FMC order dated 17.12.2013. Secondly, the entire expression, "which are an integral and essential part of Indian economy and financial system, by consolidating the businesses of NSEL and FTIL" is no part even of this answer given, but a gloss given by the High Court itself relatable to this answer.

Similarly, when it comes to reason (b), “giving effect to business realities of the case” contained in the answer to objections does not contain “by consolidating the businesses of FTIL and NSEL”, nor does it contain “and preventing FTIL from distancing itself from NSEL, which is, even otherwise, its alter ego”. On the contrary, the High Court itself mentions, in paragraph 355, that “this is also not a case where the Central Government has, in fact, lifted the corporate veil, despite the alleged non-existence of the circumstances justifying lifting of such corporate veil”, and further, “this is not a case where the Central Government has lifted the corporate veil and sought to apportion any liability upon either NSEL or FTIL”. For all these reasons, we find that no reasonable body of persons properly instructed in law could possibly arrive at the conclusion that the impugned order has been made in public interest.

60. The learned Senior Advocates appearing on behalf of the respondents has placed great reliance on the judgment in **Ganesh Bank** (supra). In this judgment, the Appellant Bank was amalgamated with Federal Bank under Section 45 of the Banking Regulation Act, 1949. Federal Bank was selected from out of several other banks by the Reserve Bank of India as its offer to amalgamate with the

Appellant Bank was unconditional, Federal Bank undertaking to make full payment to depositors.

61. The judgment in **Ganesh Bank** (supra) was faced with the amalgamation of the Appellant Bank after a moratorium had been imposed on it as it was found that its position was very weak, having incurred huge losses in the financial year 2004-05. Section 45 of the Banking Regulation Act reads as follows:

> "**45. Power of Reserve Bank to apply to Central Government for suspension of business by a banking company and to prepare scheme of reconstitution or amalgamation**.—(1) Notwithstanding anything contained in the foregoing provisions of this Part or in any other law or any agreement or other instrument, for the time being in force, where it appears to the Reserve Bank that there is good reason so to do, the Reserve Bank may apply to the Central Government for an order of moratorium in respect of a banking company.
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> xxx xxx xxx
>
> (4) During the period of moratorium, if the Reserve Bank is satisfied that—
>
> (*a*) in the public interest; or
>
> (*b*) in the interests of the depositors; or
>
> (*c*) in order to secure the proper management of the banking company; or
>
> (*d*) in the interests of the banking system of the country as a whole,—
>
> it is necessary so to do, the Reserve Bank may prepare a scheme—
>
> (*i*) for the reconstruction of the banking company, or

(*ii*) for the amalgamation of the banking company with any other banking institution (in this section referred to as “the transferee bank”).
xxx xxx xxx”

It is important to note that unlike Section 396 of the Companies Act, the satisfaction of the Reserve Bank of India can be on any one of four grounds. Such satisfaction may be in the public interest or in the interest of depositors. This point is, in fact, highlighted in paragraph 34 of the judgment as follows:

> “**34.** The phrase “good reasons” in sub-section (1) of Section 45 is a term of wide amplitude and it will not be correct to restrict it only to the actions mentioned under sub-section (2) of Section 45 of the Act as is contended by the appellants. The provision is concerned with preparing a scheme of reconstruction or amalgamation which would become necessary where RBI is satisfied about the existence of any of the four grounds mentioned in Section 45(4). Apart from public interest and the interest of the banking system, which are provided in clauses (*a*) and (*d*) thereof, Section 45(4) provides for the necessary action in the interest of the depositors or with a view to secure proper management of the Bank which are clauses (*b*) and (*c*) in that sub-section. Precursor to the framing of the scheme is the imposition of the moratorium which is provided in sub-sections (1) and (2) of Section 45. Existence of court proceedings, mentioned in Section 45(2), would certainly be one of the good reasons to impose moratorium, but that certainly cannot be the only one. Considering that object of the Act is protection of the interest of the depositors, such an interpretation of the concept of “good reasons” will have to be adopted, and not a narrow one.”

The judgment then goes on to state:

> "**39.** Now, as far as the first two questions of non-consideration of reconstruction and proposing merger with Federal Bank are concerned, RBI has noted that the Bank was in difficulties from 1990 and particularly from December 2003 when it was placed under monthly monitoring. RBI in its application for moratorium to the Central Government dated 4-1-2006 had clearly stated that during the discussion with the appellant Bank, major shareholders and Directors had shown total reluctance to merge into the stronger bank. In view thereof, it was imperative that immediate arrangement to protect the interest of the depositors was to be made through its merger with a bank under Section 45 of the Act. RBI had, therefore, made an effort and called upon the appellant Bank, that if possible, to explore the possibility of merger with another stronger bank. It had also made an effort to impress that there should be infusion of fresh capital. That was not coming. There could be a reconstruction by bringing in more money or by narrowing the size of the appellant Bank which did not appear to be feasible. The only option left was that of amalgamation."

Thus, two features of **Ganesh Bank** (supra) distinguish the said case from the facts of the present case. First, that under Section 45 of the Banking Regulation Act, the interest of the depositors is to be looked at; and it was this reason that led to the amalgamation. Secondly, this Court found that after exploring other options, the only option left was that of amalgamation.

62. In point of fact, the contrast between Section 45(4) of the Banking Regulation Act and Section 396 of the Companies Act

becomes important. Under Section 45(4)(b) and (c) of the Banking Regulation Act, the satisfaction of the Reserve Bank of India for preparing a scheme of amalgamation can be in the interest of the depositors of a particular bank or in order to secure the proper management of a particular banking company. This must be contrasted with clauses (a) and (d) of Section 45(4), which speak of public interest and the interest of the banking system of the country as a whole. This judgment, on facts, merged a financially weak bank with a financially strong bank in the interest of the depositors of the financially weak bank. It is important to note that the business of the two merged entities is the same, as also Federal Bank's (i.e., the strong bank's) willingness to merge, being an unconditional offer to merge because it felt that post merger, it could have a significant presence in western Maharashtra and the Belgaum area of Karnataka, and could augment its credit disbursal to the agricultural sector. Also, since the interest of depositors is a separate head, based upon which the Reserve Bank of India may amalgamate two banking companies, it is clear that this reason alone will not go to public interest, which is a separate head contained in Section 45(4). It is in this context that the observation contained in paragraph 44 is made, namely:

> "**44.** Under Section 45 of the Act, the primary consideration is public interest. There is an underlying object of acting swiftly and decisively to protect the interests of depositors and ensure public confidence in the banking system. The emergent situation which warrants action with expedition cannot be lost sight of while deciding the legality of the action."

As we have already seen, the "emergent situation" which obtained in 2013 was no longer there in 2016 when the final order of amalgamation was passed in the present case.

63. Valiant attempts have been made by counsel in the High Court as well as counsel in this Court to support the order on grounds which are outside the order, stating that such grounds make it clear that in any case, the Government order has been made in public interest. The celebrated passage in **Mohinder Singh Gill** (supra) states that:

> "**8.** The second equally relevant matter is that when a statutory functionary makes an order based on certain grounds, its validity must be judged by the reasons so mentioned and cannot be supplemented by fresh reasons in the shape of affidavit or otherwise. Otherwise, an order bad in the beginning may, by the time it comes to Court on account of a challenge, get validated by additional grounds later brought out. We may here draw attention to the observations of Bose, J. in *Gordhandas Bhanji* [*Commr. of Police, Bombay* v. *Gordhandas Bhanji*, AIR 1952 SC 16] :
>
> > "Public orders, publicly made, in exercise of a statutory authority cannot be construed in the light of explanations subsequently given by the officer making the order of what he meant, or of what was in his mind, or what he intended to

> do. Public orders made by public authorities are meant to have public effect and are intended to affect the actings and conduct of those to whom they are addressed and must be construed objectively with reference to the language used in the order itself."
>
> Orders are not like old wine becoming better as they grow older."

We are of the view that it is the Central Government that has to be "satisfied" that its order is in public interest and such "satisfaction" must, therefore, be of the Central Government itself and must, therefore, appear from the order itself. All these valiant attempts made to sustain such order must be rejected.

64. However, learned Senior Advocates on behalf of the respondents have cited **Chairman, All India Railway Recruitment Board and Anr. v. K. Shyam Kumar and Ors.**, (2010) 6 SCC 614, which, according to them, renders the judgment in **Mohinder Singh Gill** (supra) inapplicable where larger public interest is involved. In this judgment, **Mohinder Singh Gill** (supra) was distinguished thus:

> "**44.** We are also of the view that the High Court has committed a grave error in taking the view that the order of the Board could be judged only on the basis of the reasons stated in the impugned order based on the report of Vigilance and not on the subsequent materials furnished by CBI. Possibly, the High Court had in mind the Constitution Bench judgment of this Court in *Mohinder Singh Gill* v. *Chief Election Commr.* [(1978) 1 SCC 405]

> **45.** We are of the view that the decision-maker can always rely upon subsequent materials to support the decision already taken when larger public interest is involved. This Court in *Madhyamic Shiksha Mandal, M.P.* v. *Abhilash Shiksha Prasar Samiti* [(1998) 9 SCC 236] found no irregularity in placing reliance on a subsequent report to sustain the cancellation of the examination conducted where there were serious allegations of mass copying. The principle laid down in *Mohinder Singh Gill case* [(1978) 1 SCC 405] is not applicable where larger public interest is involved and in such situations, additional grounds can be looked into to examine the validity of an order. The finding recorded by the High Court that the report of CBI cannot be looked into to examine the validity of the order dated 4-6-2004, cannot be sustained."

It will be seen that there is no broad proposition that the case of **Mohinder Singh Gill** (supra) will not apply where larger public interest is involved. It is only subsequent materials, i.e., materials in the form of facts that have taken place after the order in question is passed, that can be looked at in the larger public interest, in order to support an administrative order. To the same effect is the judgment in **PRP Exports and Ors. v. Chief Secretary, Government of Tamil Nadu and Ors.**, (2014) 13 SCC 692 [at paragraph 8]. It is nobody's case that there are any materials or facts subsequent to the passing of the final order of the Central Government that have impacted the public interest, and which, therefore, need to be looked at. On facts, therefore, the two judgments cited on behalf of the respondents have

no application. Thus, it is clear that no reasonable body of persons properly instructed in law could possibly hold, on the facts of this case, that compulsory amalgamation between FTIL and NSEL would be in public interest.

65. Section 396(3) speaks of a shareholder's or a creditor's interest in or rights against the company resulting from an amalgamation order. Such "interest in" or "rights against" obviously refers to real and substantive rights, as opposed to rights that are only in form. A shareholder or creditor gets effected by an amalgamation order if the value of his share gets depleted as a result of the amalgamation and if dividends that have been paid to him are likely to come down as a result of the amalgamation. Likewise, a creditor of a solvent company is directly effected by an amalgamation by which the amount loaned by such creditor becomes, as a result of the amalgamation, less likely to be paid back in time, than if the amalgamation did not take place. Such rights and interests of members and creditors are substantive rights which, when effected by the amalgamation, lead to compensation having to be paid. Every shareholder of a company and indeed, every creditor of a company, is concerned only with the "economic value" of his share or the loan granted to a company, as the case may be. The moment the share value, in real terms, is likely to dip, and/or loans

granted are likely not to be repaid in time or at all as a result of an amalgamation, such members or creditors of the amalgamating company are equally entitled to be compensated for this economic loss as are the members and creditors of the amalgamated company, depending on the facts of each case. A reasonable construction must be given to Section 396. Also, the suggested construction by the respondents, as has been accepted by the impugned judgment, operates harshly and ridiculously, and being opposed to justice and reason, cannot possibly be adopted by this Court. It is clear that Section 396(3) refers to the economic loss that is to be borne by shareholders and members of both companies.

66. Thus, it is clear from a reading of Section 396(3), (3A), and (4)(aa) that every member or creditor of each of the companies before amalgamation shall have, as nearly as may be, the same interest in or rights against the company resulting from the amalgamation as he had in the original company. To the extent to which the interest or rights of such member or creditor are less than his interest or rights against the original company, post amalgamation, he shall be entitled to compensation which is to be assessed. Post assessment, if such member or creditor is aggrieved, he may prefer an appeal to the appellate authority under sub-section (3A). Under sub-section (4)(aa),

no order of amalgamation can be made unless the time for preferring an appeal under sub-section (3A) has expired, or where any such appeal has been preferred, the appeal has been finally disposed of.

67. The learned counsel on behalf of the appellant has argued that the assessment order dated 01.04.2015, passed by the Joint Director (Accounts), does not reflect any compensation in favour of the shareholders or creditors of FTIL. According to the learned counsel, it is clear that if a company with low net worth (NSEL) is amalgamated with a company with high positive net worth (FTIL), both the shareholders and the creditors of FTIL will be directly impacted as the economic value of the shares will plummet, and the creditors of FTIL, which is a positive net worth company, may have to wait for a long time before recovery of debts owed to them once the company is amalgamated with the negative net worth company. In short, the creditors of FTIL will be put on par with the creditors of NSEL, which will result in the creditors of FTIL either being paid back their debts much later in point of time, or not at all. To this argument, the answer of the Union of India, which has found favour with the Division Bench of the Bombay High Court, is that “economic value” forms no part of Section 396. So long as the shareholders of FTIL continued to have

the same number of shares, it matters not whether their share values plummet post amalgamation.

68. In **Bacha F. Guzdar** (supra), this Court held that though a shareholder acquires no right in the assets of a company as the company itself is the owner of such assets, yet a shareholder certainly has the right to dividends and the right to participate in the assets of the company which would be left over after winding up. The Court held:

> "The true position of a shareholder is that on buying shares an investor becomes entitled to participate in the profits of the company in which he holds the shares if and when the company declares, subject to the Articles of Association, that the profits or any portion thereof should be distributed by way of dividends among the shareholders. He has undoubtedly a further right to participate in *the assets of the company which would be left over after winding up* but not in the assets as a whole as Lord Anderson puts it."
>
> (at p. 882)
> (emphasis in original)

69. In **Life Insurance Corporation of India v. Escorts Ltd. and Ors.**, (1986) 1 SCC 264, this Court dealt generally with the rights of shareholders as follows:

> "**84.** On an overall view of the several statutory provisions and judicial precedents to which we have referred we find that a shareholder has an undoubted interest in a company, an interest which is represented by his shareholding. Share is movable property, with all

> the attributes of such property. The rights of a shareholder are (*i*) to elect directors and thus to participate in the management through them; (*ii*) to vote on resolutions at meetings of the company; (*iii*) to enjoy the profits of the company in the shape of dividends; (*iv*) to apply to the court for relief in the case of oppression; (*v*) to apply to the court for relief in the case of mismanagement; (*vi*) to apply to the court for winding up of the company; (*vii*) to share in the surplus on winding up. ……"

On the facts of the present case, we are directly concerned with points (iii) and (vii). It has been argued that the profits of the company post-amalgamation will obviously come down, and dividends payable to shareholders will consequently either come down or be wiped out if the low net worth of NSEL is taken into account post amalgamation, together with potential liabilities of the amalgamated company, which may have to be paid in the near future. Secondly, if the amalgamated company is wound up, the amount that is payable to the shareholders post-amalgamation will be much less, if at all anything is to be paid, than pre-amalgamation.

70. In fact, in **Commissioner of Income Tax (Central) Calcutta v. Standard Vacuum Oil Co.**, [1966] 2 SCR 367, this Court held:

> " …… A share is not a sum of money: it represents an interest measured by a sum of money and made up of diverse rights contained in the contract evidenced by the articles of association of the Company. ……"
>
> (at p. 374)

71. In **Miheer H. Mafatlal v. Mafatlal Industries Ltd.**, (1997) 1 SCC 579, in the context of a voluntary amalgamation made under Sections 391 to 394 of the Companies Act, this Court went into share valuation. This Court held:

> "**40.** …… It must at once be stated that valuation of shares is a technical and complex problem which can be appropriately left to the consideration of experts in the field of accountancy. Pennington in his *Principles of Company Law* mentions four factors which had to be kept in mind in the valuation of shares:
>
> "(1) Capital Cover,
>
> (2) Yield,
>
> (3) Earning Capacity, and
>
> (4) Marketability.
>
> For arriving at the fair value of share, three well-known methods are applied:
>
> (1) The manageable profit-basis method (the Earning Per Share Method)
>
> (2) The networth method or the break value method, and
>
> (3) The market value method."

What is clear from the various methods of valuation of shares, when it comes to such valuation *qua* the transferor and transferee company, is that the market value method is one method in which shares can be valued so that their equivalent can then be provided for in the amalgamated company. This would be nothing other than what those shares were worth in the market on a particular day or an average taken within a certain period. What is important to note is that the

market value of shares is market value of shares reflective of their economic value, being an interest measured by a sum of money, is not something that is completely alien to determining the rights of or interest of a shareholder in the transferor or transferee company, as the case may be.

72. In fact, the Government order dated 12.02.2016 itself reflects the net worth of NSEL as INR 8.86 crore from its balance sheet dated 31.03.2015, despite its capital being INR 60 crore, inasmuch as the total reserve and surplus is a negative figure of INR 51.54 crore. As against this, FTIL's balance sheet, as on 31.03.2015, discloses that for the same year, FTIL's net worth is INR 2779.94 crore. Also, FTIL has been paying dividends to its shareholders ranging from 1000% to 250% for the years 2007-2008 till 2015-2016. On the other hand, NSEL has never paid a single dividend ever since its inception. Post amalgamation, therefore, dividend payable to the shareholders of FTIL is bound to come down. Correspondingly, the 'marketable value' of such shares will also fall.

73. The impugned Division Bench judgment has incorrectly held that the economic value of shares cannot be taken into account. In fact, from the Director's Report of NSEL dated 20.07.2015, it is specifically

stated under the caption, “(vi) civil suits / complaints / writs / public interest litigation” that:

> “xxx xxx xxx
>
> c) The Company received a legal opinion to the effect that the Company is not liable for payment under the provisions of SGF in the bye-laws. Further in case of e-Series contract related transactions, no major infirmity in underlying physical stock was observed. Therefore, at this stage and in the opinion of the Management of the Company, relying upon the legal advices, and as per the provisions of bye-laws of the exchange there are no direct ascertainable financial claims against the company. The Company may be exposed to liabilities in case of any adverse outcome of these investigations / enquiries or legal cases or any other investigations / enquires or suits which may arise at a later date.”

This is further clarified in the consolidated financial statement made for the financial year 2014-2015 as follows:

> “<u>Risk of un-identified financial irregularities</u>
>
> In view of the specific scope of the forensic audits and the limitations in the forensic audits and investigations, there is inherent a risk that material errors, fraud and other illegal acts may exist that could remain undetected.
>
> <u>Risk of adverse outcome of investigation/enquiry by law enforcement agencies</u>
>
> Several agencies such as the Police (EOW), Ministry of Corporate Affairs (MCrA), Enforcement Directorate (ED), CBI and the Income Tax Department etc. are currently investigating / enquiring the extent of alleged irregularities and any breach of law. The matters are also sub judice before various forums including the Hon’ble Mumbai High Court. The Company may be exposed to liabilities in case of any adverse outcome of these investigations or any other investigations which may arise at a later date.”

From the Director's Report and consolidated financial statements of NSEL, it becomes clear that the company may be exposed to liabilities in case of any adverse outcome in any of the proceedings that may be pending, as a result of which, it may have to pay back the whole or some part of the INR 5600 crore owed to the alleged investors/traders by the 24 defaulters who are members of NSEL. This would certainly impact the 'economic value' of shares held in FTIL as this is one factor that would, post amalgamation, depress the market value of shares held by such shareholder, and would also impact the dividend payable on such shares post amalgamation.

74. The impugned judgment has also held that no material was produced before the Court to show that share prices would in fact plummet post-amalgamation. This is despite the fact that the impugned judgment itself refers to the fact that since the publication of the draft order on 21.10.2014, the share value which was INR 211.10, dropped to INR 174.55 ten days later. The Division Bench then goes on to state that it is not possible to hold that any case of serious erosion in economic value has at all been made out, inasmuch as by 21.10.2014, when the draft order of amalgamation was made available to companies, the news of collapse of NSEL's exchange was already

in public domain. This is wholly incorrect for the reason that the news of collapse took place in July, 2014, i.e., over two months before the publication of the draft order. It is well known that the stock market is extremely sensitive to the slightest event that may render a company less profitable. Over two months is too long a period to relate a share value of INR 211.10 drastically falling to INR 174.55. On the other hand, it is obvious that the publication of the draft order on 21.10.2014 had the impact of the share price reducing by a substantial amount, ten days later. In fact, a reference to the share prices of NSEL furnished by the learned Additional Solicitor General makes it clear that the moment the final amalgamation order dated 12.02.2016 was publicised, the share price fell from INR 89.90 on 12.02.2016 to INR 73.90 on 24.02.2016 and further to INR 73.10 on 29.02.2016. Incidentally, the High Court realised this, and finally incorrectly concludes, “there is thus substantial compliance with the provisions of Section 396(3).” Given the fact that the assessment order dated 01.04.2015 did not provide any compensation to either the shareholders or creditors of FTIL for the economic loss caused by the amalgamation in breach of Section 396(3), it is clear that an important condition precedent to the passing of the final amalgamation order was not met. On this ground also, therefore, the final amalgamation order

has to be held to be *ultra vires* Section 396 of the Companies Act, and, being arbitrary and unreasonable, violative of Article 14 of the Constitution of India.

75. However, the learned Senior Advocates for the respondents have argued that an order of nil compensation is equally an order that is passed under Section 396(3) which could have been appealed against but was not appealed against. For this reason, therefore, it is not correct to state that the condition precedent mentioned in Section 396(4)(aa) has not been fulfilled. It will be noticed that the language used in the appeal provision, i.e. Section 396(3A), is "any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may…… appeal to the Tribunal, and thereupon the assessment of the compensation shall be made by the Tribunal." The pre-requisites for the application of sub-section (3A) are that a person first be aggrieved by an "assessment of compensation" "made" by the prescribed authority. Where no assessment of compensation whatsoever is made by the prescribed authority (and on the facts here, the prescribed authority has not, in fact, stated that for the reasons given by it, compensation awarded to FTIL, its shareholders and creditors is nil), no person can be aggrieved by an order which does not assess any compensation, which may be

interfered with by the Appellate Tribunal which must then assess the compensation for itself. The statute clearly entitles such shareholders and creditors to have compensation assessed first by the prescribed authority and then by the appellate authority. This Court, in **Institute of Chartered Accountants of India v. L.K. Ratna and Ors.**, [1986] 3 SCR 1049, held that the defect in observing the rules of natural justice in the trial administrative body cannot be cured by observing such rules of natural justice in the appellate body. It was held:

> "It is then urged by learned counsel for the appellant that the provision of an appeal under Section 22-A of the Act is a complete safeguard against any insufficiency in the original proceeding before the Council, and it is not mandatory that the member should be heard by the Council before it proceeds to record its finding. Section 22-A of the Act entitles a member to prefer an appeal to the High Court against an order of the Council imposing a penalty under Section 21(4) of the Act. It is pointed out that no limitation has been imposed on the scope of the appeal, and that an appellant is entitled to urge before the High Court every ground which was available to him before the Council. Any insufficiency, it is said, can be cured by resort to such appeal. Learned counsel apparently has in mind the view taken in some cases that an appeal provides an adequate remedy for a defect in procedure during the original proceeding. Some of those cases as mentioned in Sir William Wade's erudite and classic work on "Administrative Law" (5th Edn.). But as that learned author observes (at p. 487), "in principle there ought to be an observance of natural justice equally at both stages", and
>
> > "if natural justice is violated at the first stage, the right of appeal is not so much a true right

> of appeal as a corrected initial hearing: instead of fair trial followed by appeal, the procedure is reduced to unfair trial followed by fair trial."

And he makes reference to the observations of Megarry, J. in *Leary* v. *National Union of Vehicle Builders* [(1971) 1 Ch. 34, 49]. Treating with another aspect of the point, that learned Judge said:

> "If one accepts the contention that a defect of natural justice in the trial body can be cured by the presence of natural justice in the appellate body, this has the result of depriving the member of his right of appeal from the expelling body. If the rules and the law combine to give the member the right to a fair trial and the right of appeal, why should he be told that he ought to be satisfied with an unjust trial and a fair appeal? Even if the appeal is treated as a hearing de novo, the member is being stripped of his right to appeal to another body from the effective decision to expel him. I cannot think that natural justice is satisfied by a process whereby an unfair trial, though not resulting in a valid expulsion, will nevertheless have the effect of depriving the member of his right of appeal when a valid decision to expel him is subsequently made. Such a deprivation would be a powerful result to be achieved by what in law is a mere nullity; and it is no mere triviality that might be justified on the ground that natural justice does not mean perfect justice. As a general rule, at all events, I hold that a failure of natural justice in the trial body cannot be cured by a sufficiency of natural justice in an appellate body."

The view taken by Megarry, J. was followed by the Ontario High Court in Canada in *Re Cardinal and Board of Commissioners of Police of City of Cornwall*, [(1974) 42 D.L.R. (3d) 323]. The Supreme Court of New Zealand was similarly inclined in *Wislang* v.

> *Medical Practitioners Disciplinary Committee*, [(1974) 1 N.Z.L.R. 29] and so was the Court of Appeal of New Zealand in *Reid* v. *Rowley* [(1977) 2 N.Z.L.R. 472]."
>
> (at pp. 1065-1066)

This judgment was the subject matter of comment in **Union Carbide Corporation v. Union of India**, [1991] Supp (1) SCR 251, where this Court held, following the judgment in **Charan Lal Sahu v. Union of India**, (1990) 1 SCC 613, that non-compliance with the obligation to issue notices to persons effected by the Bhopal gas leak did not, for this reason alone, vitiate the settlement that was entered into with Union Carbide by the Government on their behalf. This Court, in passing, commented that the principle laid down in **Leary v. National Union of Vehicle Builders**, [1971] Ch. 34 might perhaps be too broad a generalisation, except in cases involving public interest. This was an observation made in answer to an argument by Shri Shanti Bhushan, stating that a defect of natural justice always goes to the root of the matter. Ultimately, given the fact that the settlement fund was held to be sufficient to meet the needs of just compensation to the victims of the Bhopal gas leak tragedy, it was held that the grievance on the score of not hearing the victims first would not really survive. However, what is of fundamental importance is the fact that in the present situation, a clear statutory right is given to every member or creditor

who shall be entitled to an assessment of compensation, first by the prescribed authority and then, a right of appeal to the Appellate Tribunal. In such cases, therefore, the orders of “non-assessment” by the prescribed authority can more appropriately be challenged in judicial review proceedings, in which the High Court, acting under Article 226 of the Constitution of India can, if an infraction of Section 396(3) is found, send the matter back to the prescribed authority to determine compensation after which the right of appeal under sub-section (3A) of Section 396 would then follow. In fact, in Writ Petition 2743 of 2014, which challenged both the draft order and the final order of amalgamation, the appellant took out a chamber summons for amendment of its writ petition to challenge the order of assessment of compensation, dated 01.04.2015, which amendment was allowed *vide* order dated 16.02.2016. The order of “non-assessment” of compensation has thus been challenged by FTIL in proceedings under Article 226 of the Constitution of India. Even otherwise, this is a case where there is complete non-application of mind by the authority assessing compensation to the rights and interests which the shareholders and creditors of FTIL have and which are referred to in Section 396(3) of the Act. This being the case, it is clear that Section 396(3) has not been followed either in letter or in spirit.

76. In conclusion, though other wide-ranging arguments were made with respect to the validity of the Central Government amalgamation order, we have not addressed the same as we have held that the order dated 12.02.2016 is *ultra vires* Section 396 of the Companies Act, and violative of Article 14 of the Constitution of India for the reasons stated by us hereinabove. The appeals are accordingly allowed, and the impugned judgment of the Bombay High Court is set aside. The writ petition is disposed of in light of this judgment.

……J.
(R.F. Nariman)

……J.
(Vineet Saran)

New Delhi
April 30, 2019.