

## Companies Act Series

July 05, 2023

### UNILATERAL STRIKE DOWN OF COMPANIES' NAMES AND THE ADVENT OF 'ZERO REVENUE' CRITERIA

#### SUO-MOTO POWER OF ROC TO STRIKE DOWN THE NAME OF A COMPANY

The Registrar of the Companies ("RoC") is empowered to strike down the names of the companies in accordance with the provisions of Section 248(1) of the Companies Act, 2013 ("Act") read with **The Companies (Removal of Name of Companies from the Register of Companies) Rules, 2016** ("Strike Down Rules"). Recently, the RoC has been cracking down on the companies which have been violating the provisions of the Act or have been acting as shell companies, and accordingly striking off the names of such defaulting companies from the register of the companies.<sup>1</sup>

The effect of removal of a company from the register of the companies under Section 248 of the Act is that the company ceases to operate and the certificate of incorporation issued to it shall be deemed to have been cancelled except for the purpose of realising the amount due to the company and for the payment or discharge of the liabilities or obligation of the company as provided under Section 250 of the Act.

#### DUE PROCESS OF STRIKING DOWN

The Act lists out the circumstances in which the RoC can strike down the name of the Company as well as provides for due process of law to be followed while doing so.

Section 248(1) of the Act read with Strike Down Rules, lists out the circumstances that may lead to striking down the name of a company and includes:

*"(c) a company is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455"*<sup>2</sup>

If the RoC believes that Section 248(1) is attracted, then the RoC is required to send a notice to the defaulting company ("Defaulting Company") and all the directors of the company and provide them with an opportunity to respond to the RoC within a period of 30 (thirty) days from the date of the notice of RoC.<sup>3</sup>

As the removal of a company's name has severe adverse implications on a company and its stakeholders as explained above, the law provides provision of notice to the Company and its directors as well as publication of such notices on the website of the Ministry of Corporate Affairs and in newspapers to ensure that the company is aware of such action by the RoC and can defend the same.<sup>4</sup>

In the event, the Defaulting Company fails to demonstrate a reason to the RoC, within the timelines stipulated in the notice by the RoC, as to why the name of the Company should not be struck off, then only the RoC may strike off the name of the Defaulting Company from the **register of companies**.<sup>5</sup>

Accordingly, if due process is not followed, then the name of a Defaulting Company should not be struck down. However, the scope of the defaulting circumstances listed in Section 248(1) of the Act has been expanded by the RoC and the same has been upheld by the National Company Law Appellate Tribunal ("NCLAT") as well.

In view of the aforesaid provisions, we discuss the recent judgment of NCLAT in Sanmati Agrizone Private Limited vs. The Registrar of the Companies,<sup>6</sup> ("Sanmati Judgment") and the interpretation of the provisions of Section 248 of the Act.

#### UNILATERAL STRIKING DOWN OF SANMATI AGRIZONE PRIVATE LIMITED

RoC, Delhi ("RoC Delhi") unilaterally struck down the name of the company 'Sanmati Agrizone Private Limited' ("Appellant Company"), from its register of companies on the basis that the Appellant Company had not filed its financial statements for 2 (two) years. The Appellant Company even argued that no notice was issued by RoC Delhi and hence, due process was not followed by ROC Delhi, as laid down in Section 248 of the Act. However, the non-filing of financial statements by the Appellant Company was interpreted by RoC Delhi to mean that the Appellant Company was not carrying out any business. Accordingly, the name of the Appellant Company was struck down from the register of the companies.

The National Company Law Tribunal, Delhi Bench ("NCLT Delhi") in its judgement dated December 17, 2021 held the action of RoC Delhi striking down the Company basis the zero revenue from its operations, sustainable and did not discuss the unilateral action of striking down the Company.

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Thereafter, the Appellant Company, aggrieved by the decision of NCLT Delhi, filed an appeal with NCLAT challenging the judgement of NCLT Delhi. However, NCLAT in its judgment dated June 01, 2023 upheld the decision of NCLT Delhi in the following words:

*"The impugned order dated 17.12.2021, the NCLT has rightly held that the Audited Financial Statements of the two immediately preceding Financial Years i.e., 2015-16 and 2016-17 filed by the Appellant Company reflected "Zero revenue" from its operations and have come to the conclusion that the Appellant Company was neither in operation nor carrying out its business at the time of its name was struck off from the register of Registrar of Companies."*

## COMPLIANCE WITH DUE PROCESS: NOT A REQUIREMENT FOR ADMINISTRATORS?

Actions of RoC Delhi, orders of NCLT Delhi, and NCLAT in this case raise questions on two important aspects in terms of striking off of names of the companies under the provisions of Section 248(1) of the Companies Act, 2013:

- Is due process listed out in the act to keep a check on the duties and powers of the RoC, just a mere formality that can be done away with?
- Can 'zero revenue' of a company for two consecutive financial years be interpreted to mean that a company is "not carrying on any business or operation"?

During the appeal to NCLAT, the Appellant Company raised concerns that the due process for striking off the name of the Appellant Company was not followed. Striking off a company's name has severe consequences and can be equated to a 'death sentence' for a corporation. Therefore, Section 248 specifically provides for not just issuance and publication of notice by the RoC but also an obligation on the RoC to provide an opportunity to the company to defend itself against the RoC's intention to remove the company's name. This principle of natural justice, i.e. 'an opportunity of being heard' seems to have been violated by the RoC in this case and there has been no deliberation regarding the same in the Sanmati Judgment.

Various courts and tribunals have emphasised on the significance of 'an opportunity of being heard' and how the orders/actions taken in violation of the principles of natural justice are against the law.<sup>7</sup> The Apex Court in the landmark judgment of State of Orissa vs. Binapani Dei and Ors.,<sup>8</sup> while discussing the importance of right to be heard, held:

"It is true that the order is administrative in character, but even an administrative order which involves civil consequences, as already stated, must be made consistently with the rules of nature justice after informing the first respondent of the case of the State, the evidence in support thereof and after giving an opportunity to the first respondent of being heard and meeting or explaining the evidence. No such steps were admittedly taken; the High Court was, in our judgment, right in setting aside the order of the State."

Further, interpreting 'zero revenue' as 'not carrying on any business or operation' is a very broad interpretation and can impact many genuine companies going forward. 'Zero revenue' of a company could be because of lack of financial resources, wrong business decisions or failure to generate revenue even after carrying out business. The Appellant Company in the present case was regular in filing income tax returns and the income tax department confirmed that there was no outstanding income tax demand, no pending assessment, or no penalty proceedings against the Appellant Company. Moreover, the tribunals failed to appreciate the fact of the Appellant Company was regularly disbursing salaries to employees, and the audit reports of the Appellant Company did not contain any adverse remarks or qualifications which would indicate that the Appellant Company was defunct or a shell company.

The aforesaid highlights that NCLAT has impliedly allowed the violation of the due process of law and has suggested wide interpretations of provisions that are penal in nature.

## A MISSED OPPORTUNITY

It can be well argued that, NCLT Delhi and NCLAT failed to appreciate the fact that RoC Delhi's actions were against the provisions of the Act. Both, NCLT Delhi as well as NCLAT had an opportunity to fix the error made by RoC Delhi. However, the Tribunals not only missed the opportunity to rectify the error but also expanded the scope of a provision that is penal. The Sanmati Judgment will have a far-reaching effect on the companies in the times to come. The approach of other RoCs vis-a-vis the compliance of the procedure set out in Section 248 of the Act is yet to be seen in light of this precedent.

— Akash Kumar, Harshita Srivastava & Santosh Gangavati

You can direct your queries or comments to the authors.

<sup>1</sup>BS Web Team, MCA plans to further intensify crackdown on shell companies: Report, Business Standard, June 20 2023, available at: [https://www.business-standard.com/economy/news/mca-plans-to-further-intensify-crackdown-on-shell-companies-report-123062000651\\_1.html](https://www.business-standard.com/economy/news/mca-plans-to-further-intensify-crackdown-on-shell-companies-report-123062000651_1.html)

<sup>2</sup>Other situation mentioned in Section 248(1) are: (a) a company has failed to commence its business within one year of its incorporation; (d) the subscribers to the memorandum have not paid the subscription which they had undertaken to pay at the time of incorporation of a company and a declaration to this effect has not been filed within one hundred and eighty days of its incorporation under subsection (1) of section 10A; and (e) the company is not carrying on any business or operations, as revealed after the physical verification carried out under sub-section (9) of section 12.

<sup>3</sup>Section 248(1) of the Act.

<sup>4</sup>Section 248(1) of the Act read with Rule 7 of the Striking Down Rules.

<sup>5</sup>Section 248(5).

<sup>6</sup>Company Appeal (AT) No. 27 of 2022, dated June 01, 2023

<sup>7</sup>See, Navneet R Jhanwar vs. State Tax Officer and Ors, WP (C) No. 443/2021, decided on March 17, 2021.

<sup>8</sup>1967 SCR (2) 625.

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