



Surana & Surana National Corporate Law  
Moot Court Competition  
JSS Law College, Mysore  
17 – 19 February 2017



**BEFORE THE HONOURABLE HIGH COURT OF KARNATAKA**

Company Application (CA) 1 of 2017

Company Application (CA) 2 of 2017

Company Application (CA) 3 of 2017

in

Company Petition (CP) 10 of 2017

(Winding-up Petition)

1. *Global Office Suppliers Pvt Ltd, Bengaluru*
2. *Shareholders of Stalwart Online Stores Pvt Ltd*
3. *Additional Commissioner of Income-tax, Bengaluru*
4. *Deputy Commissioner of Commercial Tax, Bengaluru*

v/s

*Stalwart Online Stores Pvt Ltd, Bengaluru*

1. Global Office Suppliers Pvt Ltd (Global or the main petitioner) is a company incorporated under the Indian Companies Act, 1956 having its registered office in Bengaluru. It is into the business of sale of office equipments ranging from stationery items to laptops, etc. to various customers within India and mainly, within Bengaluru. The petitioner buys its inventories from various manufacturers within and outside Bengaluru and sells them to customers. It has registered itself with Karnataka Value Added Tax (VAT) authorities. It imposes VAT or Central Sales Tax (CST) on its sales based on the sales within or outside the state of Karnataka.
2. Stalwart Online Stores Pvt Ltd (Stalwart or the respondent) is a company incorporated under the Companies Act, 2013 and is having its registered office in Bengaluru and has its corporate office in Chennai. It is into the business of selling various stationery items to its customers across India through its online portal i.e. it is an ecommerce entity. Stalwart has its main server to support the online transactions in its Chennai corporate office. Stalwart follows both inventory model and marketplace model with separate website address for each model. Under the inventory model, it directly sells the goods to the consumers and under the marketplace model, it, in a way, sells the goods to the consumers (mainly retailers) through its suppliers by facilitating in connecting the online buyers with the actual sellers. Under the marketplace model, Stalwart would receive the money from the customers for the sales made and would take its commission and remit the remaining amount to the actual sellers. Stalwart has registered itself as a 'dealer' with both the Karnataka and Tamil Nadu VAT authorities but only for its inventory model business.

3. Stalwart is a successful startup company from the date it was set up on October 01, 2014 and has around 40% market share of the marketplace model sales and 20% market share of the inventory model sales in the stationery items. Given its success story, it was able to rope in some of the prominent private equity investors and high networth individual (HNI) investors both within India and from overseas. Since its inception it has been raising the needed capital from its investors and with its cutting edge technology and professional management, it has been achieving whopping sales and profits.
4. Knowing the high quality and reasonable price of the stationery items sold by Global, Stalwart was keen to have an agreement with Global for its business activities. Given that Stalwart operates under both models, it wanted the support of Global to deliver the goods directly to Stalwart's customers under its marketplace model and also to sell the required goods to Stalwart under its inventory model. Stalwart approached Global about its business plan and Global was readily impressed and agreed to the collaborative initiative.
5. Both the companies entered into Sales-cum-Service Agreement (SSA) on January 01, 2015 and registered it in Bengaluru. The agreement broadly captured various rights and obligations of both the parties. In specific, the agreement had a clause where Global will sell the required items directly to Stalwart as and when Stalwart needs such items for its inventory model and Global will directly supply the goods to the customers of Stalwart when the customers make online purchases under its marketplace model. Under the inventory model, Stalwart should make the payment for the goods sold by Global within three working days. Failing which, Stalwart will have to issue Post Dated Cheques (PDCs) on the fourth day towards the invoices raised and in the event if the cheques are dishonored by Stalwart's bank, Stalwart will have to pay 24% simple interest per annum on the amount pending and will also have to pay a penalty of INR 20,00,000 lakhs per month until the dues are settled. The minimum purchase of goods by Stalwart per month should be at least INR 1 crore. Such strict clause was incorporated at the behest of Global because it will have to obtain financial support from its lenders to buy and promptly sell the goods to Stalwart and, at times, Global will have to raise overdraft from its banks for procuring the goods to be supplied to Stalwart. This penal clause was to ensure prompt payments by Stalwart to Global. On the other hand, Global will have to promptly supply the items to the customers of Stalwart under marketplace model. There was a general arbitration clause in the agreement in case if any disputes arise between the parties.
6. Based on the agreement, from January 2015, Global has been supplying stationery items worth crores to Stalwart under the inventory model and has been raising invoice typically at the end of every month. Stalwart was able to settle all the invoices raised by Global within the three days' time limit for the initial few months. However, given the rise in competition in the second half of the calendar year 2015 and because of few Foreign Direct Investment (FDI) regulatory issues on its inventory and marketplace models faced by Stalwart, there was dip in sales and Stalwart was not able to settle the invoices raised by Global from July 2015. As per the agreement, Stalwart drew six cheques for the invoices pending till December 2015 each cheque amounting INR 1 crore. Surprisingly, all these cheques were dishonored by Stalwart's bank due to insufficient funds. However, given the good relations between the parties and since Stalwart was only suffering temporary hiccup in its business, Global voluntarily continued to supply the goods to Stalwart being one of its major customers.

7. Global continued to supply the required items to Stalwart from January 2016 to June 2016 and raised invoices every month end for INR 1 crore each amounting to INR 6 crores. However, Stalwart was again unable to settle the invoices from January 2016 to June 2016 in addition to the pending dues from July 2015 to December 2015 and continued to issue PDCs for every month. In the meantime, Stalwart was making some intermittent payments to Global as and when it had some good sales. Stalwart had made six online transfers to Global between July 2015 and June 2016 to the tune of INR 6 crores, however, without mentioning to which of the invoices and amounts pending these payments pertain. Global had acknowledged to Stalwart the receipt of this INR 6 crores.
8. On the part of Global, during the period between July 2015 and June 2016, there were several delays in delivery of goods to the customers of Stalwart under the marketplace model and there were several complaints from customers with regard to the quality and specification of the goods delivered by Global. This started to adversely affect the sales of Stalwart under the marketplace model and gave space for its competitors to fill the gap. This issue was repeatedly flagged by Stalwart to Global and Global admitted its deficiency of services and the drop in quality of goods which it promised will take care in the due course.
9. Global was being hard pressed by its financiers and its banks to pay the interest and the principal amount it borrowed for purchase of goods. Therefore, from July 2016, Global started to seriously demand Stalwart on the pending amounts including the interest and penalty which it owes to Global. Global also stopped supplying goods to Stalwart from July 2016 under the inventory model as the pending invoices were not settled by Stalwart. Stalwart admitted its liability and mentioned that it has been undergoing some bottlenecks in its business activity and in spite of that it has been paying certain amounts now and then. Stalwart also mentioned that there was severe deficiency of services on the part of Global also in the prompt and quality delivery of goods which affected its marketplace model business which was its major stream of income and that it also contributed to the decline in profits which resulted in not clearing the pending amounts promptly.
10. Apart from the above facts, Stalwart had an authorized share capital of INR 500 crores, issued share capital of INR 350 crores and paid-up share capital also of INR 350 crores. The shareholding pattern of Stalwart was as follows (all voting stocks):
  - Two Indian promoters of Stalwart held 40% in the company
  - Sam, one of the HNIs, an Indian citizen and a tax resident, held 10% in the company
  - One of the private equity investors, namely, Galileo Investors Pte. Ltd situated in Singapore held 24% in the company
  - The remaining 26% shares were held by resident shareholders. Notably, Sam also holds 24.99% voting shares in Galileo Investors Pte. Ltd., a company registered as per the corporate laws of Singapore.
11. In the month of February 2016, Stalwart had advanced loans to Galileo Investors Pte. Ltd to the tune of INR 50 crores out of its sales proceeds. Since Galileo Investors Pte. Ltd was holding 24% stake in Stalwart, Stalwart was constrained to heed to its demand. There was no written loan agreement or any other record to have advanced this amount to Galileo Investors Pte. Ltd. There was only one board resolution of Stalwart to have advanced this amount and the 26% remaining shareholders were not aware of this loan advancement. In the said board resolution,

only the two Indian promoters, Galileo Investors Pte. Ltd. and Sam voted. When the remaining 26% shareholders came to know about the transaction they were shocked that this transaction appears to be siphoning of funds from the Indian company to the Singapore investor and was not allowed as per Indian Companies Act. They were also worried that they were kept in the dark about this transaction and no proper notice was served on them about the board meeting which passed the resolution. They felt that this was a clear case of related party transaction (RPT) under the Companies Act, 2013 and the related Rules and such loan advancement was prohibited under the Act. They believed that Stalwart, Galileo Investors Pte. Ltd. and Sam were related parties. They also felt that as per Companies Act, 2013 and the Companies (Amendment) Act, 2015, this required special resolution approval from the shareholders in its general meeting which was not obtained by Stalwart. On enquiry by the 26% shareholders with the interested board members, the latter informed that this transaction does not violate Companies Act, 2013 and was also not a case of RPT and there was no need to obtain any shareholders approval much less approval by special resolution. But the 26% shareholders argued that the interested parties should have abstained from voting in the shareholders meeting and only the uninterested shareholders should have passed the special or ordinary resolution, as the case may be, since Stalwart and Galileo Investors Pte. Ltd. are related parties and such loan advancement is prohibited. This issue was pending.

12. Separately, Stalwart filed its income-tax return of income (ROI) for the FY 2015-16 before September 30, 2016. It was noticed by the income-tax department (ITD) that the above said loan advancement by Stalwart to the Singaporean entity i.e. Galileo Investors Pte. Ltd. was a 'dividend' as per the Income-tax Act, 1961 (the IT Act) and therefore, appropriate taxes should have been withheld by Stalwart while advancing the loan amount as per the applicable tax rates either under the IT Act or under the India - Singapore tax treaty. Since no tax was withheld by Stalwart on this loan advancement, the ITD issued a notice under section 201 of the IT Act read with applicable provisions of the IT Act and the tax treaty to have failed to withhold tax and treated Stalwart as assessee-in-default. Stalwart vehemently opposed this notice stating that this INR 50 crores loan advanced by Stalwart can never be treated as Galileo Investors Pte. Ltd.'s income as it will be repaid at some later point in time. Stalwart tried to rely on India -Singapore tax treaty for narrowed definition of the term 'dividend' so that it will be out of section 201 proceeding initiated by ITD. But ITD was of the view that this loan advancement was income in the hands of Galileo Investors Pte. Ltd. and therefore, taxes should have been withheld by Stalwart. The proceeding was pending.
13. Adding to Stalwart's misfortune, the Sales Tax Department (STD) of Bengaluru, Karnataka issued a notice to Stalwart stating that it has failed to register itself as 'dealer' under the marketplace business model also and failed to discharge VAT and CST liabilities on its marketplace business model because as per the expansive interpretation of the term 'dealer' under the Karnataka VAT Act, 2003 (KVAT Act, 2003), Stalwart was *indirectly involved in supplying and distributing goods for a commission* and therefore, was a 'dealer' under its marketplace business model also and it was required to pay VAT and CST on its intra state and interstate sales. Stalwart forcibly opposed this notice stating that it has been discharging VAT and CST on its inventory based model but it is not required to pay VAT or CST on its marketplace model as it is only a service provider in facilitating by connecting its customers with the actual sellers of goods like Global and relied on various judgments in this regard. It further said that the main server which supports the marketplace model was located in Chennai, Tamil

Nadu and therefore, if at all it is liable to pay sales tax, it should be only in the Tamil Nadu and not in Karnataka. However, the STD argued that the issue at hand is evolving and did not accept Stalwart's arguments and initiated action under the KVAT Act, 2003 for recovery of sales tax (VAT & CST) on the sales made by it under marketplace business model.

14. Under these circumstances, Global served a legal notice on Stalwart on December 31, 2016 under section 434(1)(a) read with section 433(e) of the Companies Act, 1956 to have failed to pay the principal amount of INR 12 crores, applicable interest of INR 4.32 crores (from July 2015 to December 2016) and fixed penalty of INR 3.60 crores (from July 2015 to December 2016) totaling to INR 19.92 crores. Global admitted in its legal notice that Stalwart had paid INR 6 crores randomly during this period and further mentioned that this INR 6 crores is being adjusted towards the penalty first and then on the interest on the pending amounts and that Stalwart was still required to pay INR 13.92 crores as on December 31, 2016. Global also filed a Summary Suit under Order XXXVII of the Code of Civil Procedure, 1908 before the City Civil Court, Bengaluru for early recovery of the above amount from Stalwart. Stalwart on the other hand, replied through its counsel that the legal notice issued by Global was bad in law as the cause for non-payment of the pending amounts was mainly due to deficiency of services by Global to Stalwart marketplace model customers which significantly hit Stalwart profits. Further, the INR 6 crores was paid towards the principal amount and therefore, the exorbitant interest and penalty computed by Global was not in accordance with law and agreement entered between them and therefore, the exorbitant interest and penalty computed by Global is only partly correct since half of the principal amount has already been settled by Stalwart.
15. After having waited for the statutory period as mentioned in section 434 of the Companies Act, 1956, Global filed a winding up petition before the Hon'ble Karnataka High Court to wind up Stalwart and to appoint an Official Liquidator to settle the dues of Global and to pass such other orders as the court deems fit. Stalwart was served with court notice and it made its appearance before the court and questioned the jurisdiction of the Karnataka High Court since there were two alternate remedies available to Global as a summary suit has already been filed by Global which is pending and that the agreement between them had an arbitration clause to settle any disputes between them, especially, for such minor and temporary issues and therefore, Global should not have initiated both the winding up petition and including the summary suit since an arbitration remedy was available. In any case, Stalwart argued that it is an upcoming company and has had great track record initially and therefore, nipping the company in the bud by winding up to have not paid few crore rupees to one creditor is not the solution as the company expects to do well in the forthcoming years and it would adversely affect the existing and prospective investors in the company including thousands of workers.
16. While the above winding up petition was pending before the Karnataka High Court, the above referred 26% shareholders of Stalwart filed an impleading petition in this winding up petition stating that Stalwart had conducted a related party transaction and the loan advancement was not as per the 'spirit' of the Companies Act, 2016 and was against the interest of the company and its shareholders, i.e., these 26% shareholders. They argued that the transaction may result in siphoning of INR 50 crores by Galileo Investors Pte. Ltd and that their approval was not sought both in the board meeting and shareholders' meeting which makes them feel depressed or at least, oppressed! They feared that this may continue in the future without their knowledge. Therefore, they contended that under section 433(f) of the Companies Act, 1956 also the

company was liable to be wound up. To this, Stalwart strenuously objected the petition on the ground of *forum non conveniens* and also on merits stated that the loan advancement was not prohibited under law. It further argued that RPT is not applicable to private limited companies post the Companies (Amendment) Act, 2015 and further, the directors who hold 74% shareholding in the company have approved the transaction in the board meeting. To this, the 26% shareholders argued that even post the Companies (Amendment) Act, 2015, this transaction will still be covered as RPT by private limited companies. The impleading petition is pending before the court.

17. The Income-tax department and the Karnataka Sales Tax Department also filed impleading petitions independently though they will be issued notice by the court once the Official Liquidator is appointed. Both the tax departments argued that they also have sizeable tax claims against Stalwart and therefore, it was important for them to appear and to be heard to ensure that their dues are correctly crystallized and paid first at par with other secured creditors. The Additional Advocate General (AAG) of Karnataka was appointed by both the tax departments to represent their interests before the High Court with the assistance of the respective standing counsels. Stalwart opposed both the petitions filed by the tax departments as premature and reiterated against the ITD that the payment made was not income in the hands of the Singapore entity and that it was not dividend under both the IT Act and India-Singapore tax treaty. Against the STD, Stalwart argued that it was only a service provider under the marketplace model and it is already discharging service tax on the commissions it receives. Further, in any case, only state of Tamil Nadu has the right to impose sales tax since the main server and the corporate office were situated in Chennai.
18. The Karnataka High Court directed the High Court Registry to tag all the impleading petitions together and to post the matter on a particular date as a specially ordered matter under its discretionary powers to decide on the maintainability of all the impleading petitions, maintainability of the main winding up petition and also to decide the case on merits on all counts. The 26% shareholders appointed the same senior advocate as appointed by Global to represent their case. ITD and STD were represented by the AAG of Karnataka. The respondent Stalwart was represented by two eminent senior counsels to handle the corporate law and tax law issues respectively.
19. The matter has come up for hearing for disposal as directed by the Karnataka High Court and the Court was pleased to grant liberty to all the parties to raise any other issues apart from addressing the above issues and the liberty to prioritize their order of arguments.