
(2006) 06 MAD CK 0285

In the Madras High Court

Case No : C.P. No's. 25, 26, 27, 28 and 98 of 2006 and C.A. No's. 108 to 112 of 2006

G. Ramesh and Others

APPELLANT

Vs

Registrar of Companies

RESPONDENT

Date of Decision : 27-06-2006

Acts Referred:

Companies (Court) Rules, 1959 — Rule 11

Companies Act, 1956 — Section 220, 628, 63, 633, 633(1)

Citation : (2006) 06 MAD CK 0285

Hon'ble Judges : Chitra Venkataraman, J

Bench : Single Bench

Advocate : T.K. Bhaskar, for the Appellant; N.P. Kumar (SCGSC), for the Respondent

Final Decision : Allowed

Judgement

Chitra Venkataraman, J.—These petitions are filed u/s 633(1) and (2) of the Companies Act, 1956, read with Rule 11(a)(23) of the Companies (Court) Rules, 1959.

2. It is stated that the petitioner was appointed as a director of the company by name M/s. P. K. Vaduvammal Finance and Investment P. Ltd. It is stated that the petitioner continued as a director till his resignation on November 14, 1996. The name of the company stood changed to M/s. Vaduvammal Finance Ltd. (hereinafter referred as "the company") on May 19, 1997.

3. The main objects of the company are stated as to carry on the business of buying and selling, hiring and letting on hire, leasing and letting on lease of movable properties of all kinds and office equipment of all kinds, security system, tractor, tiller, thresher, dryer, two wheelers and three wheelers and motor vehicles of all kinds, ships, boats, submarines and all kinds of ocean going vessels, aircrafts, helicopters and all kinds of air-borne carriers ; to carry on the business of hire purchase of immovable and movable properties of any kind and

to institute enter into, carry on, subsidise, fine or assist in subsidising or financing the sale and maintenance of any goods, article or commodities of all and every kind and description and to import, export or otherwise deal in goods, produce, articles and merchandise ; to carry on and undertake the business of financiers, in particular, the business of financing industrial enterprises. In short, a perusal of the memorandum of association shows that the activities extended were on large area including the funding and advancing money.

4. It is submitted that originally the authorised capital of the company is Rs. 4,00,00,000 fully divided into 40,00,000 equity shares of Rs. 10 as on March 31, 1997. On January 11, 1995, the private limited company became a public limited company. On March 20, 1995, the company decided to make a public issue of 15 lakhs equity shares of Rs. 10 each at par aggregating to Rs. 1.5 crores. The reasons for which the company invited public subscription are as follows:

- (i) To meet the long-term working capital requirements of the company ;
- (ii) To raise resources for deploying in the business of the company, viz., leasing, hire purchase, bills, discounting, intercorporate deposits ;
- (iii) To improve infrastructure facilities of the company;
- (iv) To get the shares of the company listed in recognised stock exchange ; and
- (v) To meet the expenses of the issue.

5. It is further stated that the one Mr. N. Subramanian came forward to purchase shares from the petitioner and other directors to take over the management of the company. On November 14, 1996, all the directors, including the petitioner have resigned from the directorship of the company and the same has been duly registered with the Registrar of Companies on November 15, 1996, in Form No. 32. A set of new directors, viz., N. Subramanian, S. Dheenadayalu and R. Venkatesan took over the management of the company. It is stated that N. Subramanian was the managing director of the company and he was in charge of the day-to-day affairs of the company. The petitioner states that on and from November 15, 1996, the erstwhile directors had nothing to do with the affairs of the company. It is stated that during the year 2004, certain officer of the Economic Offences Wing started sending notices to the erstwhile directors of the company after filing of a complaint for non-filing of returns relating to the period from April 1, 1997, onwards, to appear before the judicial magistrate. It is further stated that till the date of take over, all returns have been filed in proper compliance with the statutory requirements.

6. Learned Counsel for the petitioner referred to the fact that the erstwhile directors were not made parties to the proceedings before the criminal court. On September 27, 2004, a few officers from the Economic Offences Wing visited Mr. P. C. Bhaskar, one of the erstwhile directors of the company, in his premises and enquired about the activities of M/s. Novel Finance (India) Ltd. A statement was also recorded. A letter was written by the said Bhaskar to the respondent

appraising him of the reconstruction of the company and that the erstwhile directors had nothing to do with the management and affairs of the company. It is also stated that the said Bhaskar also enclosed copy of the documents including the letter dated July 11, 1997, of Mr. N. Subramanian, wherein it has been specifically stated that the management had been taken over by N. Subramanian with effect from November 14, 1996. In the light of the above statement, the petitioner submits that he was under the bona fide impression that the petitioner had provided the respondent with all the relevant information and necessary details required by the respondent. It is also seen that the petitioner had co-operated in the questioning of the affairs of the company. Further, for a lapse of seven years, the petitioner received a show-cause notice from the respondent herein alleging that the company did not take any steps to implement the business plans referred to in the prospectus and had thus failed to fulfil the promises made by it to the public while offering the shares through the prospectus issued by the company. The company has not filed the balance-sheets and annual reports since its incorporation. The statements made by the company in the prospectus, referred to above were, therefore, not true and the same were made with the intent to defraud the public to whom the shares were offered. The petitioner was given to show cause under notice dated December 23, 2004, as to why prosecution should not be launched against him for the offence committed by him u/s 628 of the Act.

7. It is stated that the show-cause notice was issued to G. Ramesh, P. K. C. Ramesh, P. C. Bhaskar, P. C. Shyam Sunder and K. R. Niranjana Kumar. It is further seen that notice was replied on January 3, 2004, refuting the charges. In the reply, it is stated that the affairs of company had gone into the hands of N. Subramanian and others and on and from November 14, 1996, the petitioner had nothing to do with the affairs of the company. As early as September 27, 2004, P. C. Bhaskar had given all the particulars relating to the company and the same has been received by the office of the Registrar of Companies on September 30, 2004. It is also stated that all the statutory obligations till the change of management had been complied with. In the circumstances, the petitioner pleaded for dropping of the proceedings.

8. Since the petitioner had his own doubt as regards the fate of the reply, a suit was filed before the XVI Assistant City Civil Court, Chennai, in O. S. No. 6581 of 2004. In I. A. No. 21911 of 2004, they prayed for an interim injunction restraining the respondents from initiating or continuing any proceedings against the erstwhile board of directors, viz., G. Ramesh, P. K. C. Ramesh, P. C. Bhaskar, P. C. Shyam Sunder and K. R. Niranjana Kumar. By order dated January 7, 2005, the learned XVI Assistant City Civil Judge, passed an order that none represented the first respondent, counsel for the second respondent present, viz., the Registrar of Companies, counter of R1, R2 by January 20, 2005, all till then, the parties were directed to maintain status quo. It is stated that subsequently the suit itself was withdrawn and this application is preferred before this Court praying for quashing the notice.

9. Mr. T. K. Seshadri, learned senior counsel appearing for the petitioner submits that notice issued was totally unsustainable and not in accordance with law inasmuch as the management had complied with the statutory obligations and that even after receiving the petitioner's letter pointing out to this, the respondents had proceeded with the allegations contained without any justification. It is also stated that the complaint had been filed before the Additional Chief Metropolitan Magistrate (Economic Offences) Egmore, Chennai-8, in EOCC Nos. 751 to 756 of 2002 and EOCC Nos. 40 to 42 of 2004. He further submits that narration of events and the documents filed in support demonstrate that the erstwhile directors had nothing to do with the company. Apart from this, it is also stated that for the purpose of proceedings under Sections 63, 68 and 628, what is relevant is mens rea, a culpable mind that there must be a statement lacking in material particulars made knowingly to be false. It is further stated that the petitioners acted as per the norms of the prospectus and that they could not be proceeded against. It is further stated that for want of material particulars in the notice indicating specific allegations as regards the alleged offences, the notice deserves to be rejected for its vagueness too. Learned Counsel brought to my attention the provisions of Sections 63, 68 and 628 of the Companies Act to impress on the fact that non-fulfilment of the promise made by the company in the prospectus or non-filing of the balance-sheets and annual reports are the concern of the company of which, viz., N. Subramanian, Dheenadayalu and R. Venkatesh are the directors and who are responsible for the compliance with the provisions. As such, the proceedings against these petitioners deserved to be dropped. Learned senior counsel for the petitioner prayed for quashing of the notice.

10. In the course of hearing, the learned senior counsel for the petitioner also placed reliance on the decision reported in Hafez Rustom Dalal Vs. Registrar of Companies, . He also took me through the complaint filed against the petitioner.

11. The learned senior central Government standing counsel appearing for the respondent has filed a counter on behalf of the Registrar of Companies. In the counter it is stated that the company had invested money on furniture, vehicles and details of these assets are totally unexplained. The counter further stated that funds had been utilized for the purpose other than one stated in the prospectus, viz., investment in furniture, vehicles and loans. That the company had given loans which were not supported by proper security. Referring to various clauses in the prospectus, the learned senior central government standing counsel submitted that more than 9 lakhs shares were allotted to the petitioners on June 18, 1995, and hence, the petitioners are shareholders for more than 25 per cent, of post issue capital till June 2000, and they have the responsibility to answer the same. It is further stated that in view of the violation of the terms of the prospectus and SEBI guidelines, the petitioners are liable to be proceeded against. The petitioners had resigned from the company one and half year after the issue of prospectus. Hence, the petitioners cannot escape from the liability u/s 633 of the Companies Act. It is also stated that in paragraph

7 that the Ministry of Company Affairs had taken steps against the company in question treating the said company as a vanishing company as the company had failed to comply with the statutory obligations in filing returns to the Registrar of Companies for the past 10 years. Hence, there was no error on the part of the respondent in taking action. He also submitted that the petitioners, as signatory to the prospectus, were responsible to the public in respect of assurance made in the prospectus. It is further submitted that the petitioners cannot shift the responsibility on any other person under the pretext of change of management effected after a lapse of 1 1/2 years of the date of issue of the prospectus. He also referred to a civil suit in O. S. No. 6581 of 2004, before the XVI City Civil Court, Chennai, and the same was withdrawn on February 3, 2006.

12. Learned Counsel for the respondent brought to my attention the prospectus as well as the balance-sheet for the year ended March 31, 1996. It is stated that the company has granted loans and advances on the basis of the security by way of pledge of shares and debentures. It is also stated that the company could have no huge investment in furniture and office equipment greater than as stated in the public issue prospectus. In the context of the same, it is submitted that the show-cause notice is sustainable on facts and in law. The show-cause notice shows extract from the statements given in the prospectus and their intention to defraud the public was clear from the materials.

13. It is admitted by the respondent that there are no complaints from any public as regards the utilisation of funds nor from any shareholder. There are no materials placed in the show-cause notice substantiating the allegations that the public money received had been invested on terms other than disclosed in the public issue. It may be seen, as admitted by the learned senior central government standing counsel, the present notice rests on the balance-sheet details on the investment. There is no investigation as to the account entries with reference to the balance-sheet details.

14. Learned Counsel appearing for the respondent submitted that there are nearly 250 cases wherein the Government of India has decided to take action and that the petitioner-company is one such vanishing company which need to be prosecuted for the offence committed in diverting the money received on public issue from the stated purpose. Whatever be the merit of the claim of the respondent to proceed against the companies committing the breach, one cannot deny the fact that the action contemplated must have definite materials disclosing the breach, that on mere surmises, the authority cannot base the allegations proposing penal consequences. The allegations in the counter-affidavit is that there had been default in filing the statutory returns and the public money had been misused.

15. Now looking at the first of charge, it may be seen that the consistent case of the petitioners herein is that statutory returns were regularly filed, at least, till the time that they were on the board, a fact upto which alone, they are competent to answer. Except to say that the statutory requirements are not

complied with the notice lacks in particulars as to why the statement originally given by the petitioner emphasizing this had not been verified at all. It is stated in the counter itself that the company has not filed any balance-sheet after March 31, 1997, it being a violation of Section 220 of the Companies Act, nor had they filed annual report after 1997. It is an admitted fact that the present petitioners had resigned from the board and the company had been given to the management of N. Subramanian and others and on and from November 14, 1996, onwards. On the face of the very admission in the counter, the allegations in the notice fails that the statutory prescriptions on the question of balance-sheet had not complied with.

16. As regards the allegations of balance-sheet entries as on March 31, 1996, the notice does not disclose the material or basis for such an allegation. It may be seen that it is very unsafe to go just by the balance-sheet details as regards the investment thereon without any reference to the finances of the company in the year under consideration. The respondent had not anywhere stated that the company is not a going concern. By mere adverting to the asset addition in the form of furniture, it is not known how the respondent presumed the diversion of funds for the purpose other than one stated in the prospectus. The counter throws the burden of proof on the petitioners to prove that they had acted honestly and reasonable to relieve one from the proceedings initiated u/s 633 of the Act, a view totally unsustainable, more so in the context of the very basis of the notice unexplained. It is further seen that the allegations contained in paragraph 7 runs contra to what had been admitted in page 4. In the above circumstances, the allegations cannot be sustained solely on what had been relied on in the notice issued to the petitioners.

17. It is a fundamental principle of any jurisprudence that where a notice proposes any corrective action and more so in a case of punitive action, the materials forming the basis of an opinion need to be disclosed thereby their nexus, so that the opportunity granted is realistic in its content and form. The purpose of issuing notice itself is to disclose so as to enable the accused to answer the charges.

18. It may be noted that it is no doubt true that the courts will not interfere with the notice proposing action yet, in a case where the notice does not disclose the basis of the opinion or view or where there is no rational intelligible nexus between the reasons and the materials, interference by this Court is certainly called for in such cases. Principles of fair play require that there is a disclosure of the basic and primary facts which establishes a link between the material and the offence alleged.

19. While touching on the power of the officer in reopening an assessment under the Income Tax Act, 1961, the Supreme Court in a case reported in Income tax Officer, Calcutta and Others Vs. Lakhmani Mewal Das, , after referring to the decision reported in Calcutta Discount Company Limited Vs. Income Tax Officer, Companies District, I and Another, , held that (page 448):

As stated earlier, the reasons for the formation of the belief must have a rational connection with or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Income Tax Officer and the formation of his belief that there has been escapement of the income of the assessee from assessment in the particular year because of his failure to disclose fully and truly all material facts. It is no doubt true that the court cannot go into the sufficiency or adequacy of the material and substitute its own opinion for that of the Income Tax Officer on the point as to whether action should be initiated for reopening assessment. At the same time we have to bear in mind that it is not any and every material, howsoever vague and indefinite or distant, remote and far-fetched, which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment.

20. The reasons given in the notice herein clearly show that there are no materials to link the allegation to substantiate the belief, apart from the fact that the notice ignores the statement of the petitioner as regards their compliance with the provisions of the Act. The balance-sheet figures per se does not offer any materials to form a belief as contented by the learned senior central government standing counsel. In the circumstances, I have no hesitation in rejecting the plea of the respondents and in allowing this petition.

21. Learned Counsel for the respondent pleaded liberty to issue fresh show-cause notice containing the details regarding the allegations. I do not think that this Court should reserve any such liberty. If the statute permits, one does not require the liberty from this Court. Learned senior central government standing counsel also submitted that if order is quashed, this could become a precedent to other matters. This plea has no justification for the simple reason that each case has to be considered on the individual merits and on the facts peculiar to a particular case. In the circumstances, the company petitions are allowed. No order as to costs. Consequently, connected C.A. Nos. 108 to 112 of 2006 is closed.