

(2014) 08 RAJ CK 0009

In the Rajasthan High Court

Case No : Company Application No. 5 of 1995 in Company Petition No. 20 of 1988

Official Liquidator

APPELLANT

Vs

D.D. Sinha and Others

RESPONDENT

Date of Decision : 21-08-2014

Acts Referred:

Companies Act, 1956 — Section 235, 303, 303(2), 305, 306

Citation : (2015) 125 CLA 481 : (2015) 189 CompCas 150 : (2015) 2 CompLJ 397

Hon'ble Judges : Mohammad Rafiq, J

Bench : Single Bench

Advocate : G.K. Garg, Senior Advocate and Gaurav Sharma, Advocates for the Appellant; V.L. Mathur, Advocates for the Respondent

Judgement

Mohammad Rafiq, J.—This company application was filed by the official liquidator way back on October 31, 1994, under section 543(1) of the Companies Act, 1956, inter alia, with the prayer that the conduct of the respondent ex-directors of the company (in liquidation) be examined and they be directed to handover the movable and immovable properties to the official liquidator along with records and books of account of the company and be further directed to make payment of interest at such rates as this court deem fit and to contribute such sums to the assets of the company by way of compensation in respect of retention, misfeasance and breach of trust together with interest at such rates as this court decides. The facts of the case briefly stated are that the Rajasthan Commercial and Industrial Finance Ltd., was ordered to be wound up by order of this court dated November 3, 1999, as voluntary winding up and the official liquidator was appointed as its liquidator. This court appointed Shri R.M. Khandelwal, chartered accountant on the basis of application submitted by the ex-directors of the company for preparation of statement of affairs under section 454 of the Companies Act. The statement of affairs as on December 31, 1987, was prepared by the said Shri R.M. Khandelwal. The said chartered accountant

submitted his report on October 6, 1993. He has mentioned therein that he was not provided complete records and books of account, especially the records of the period from January 1, 1988 to November 3, 1989, were not available. Transaction during that period were in the nature of collection of money against deposits schemes, loan recovery and security deposits. Subsequently, this court appointed Shri N.C. Jain, chartered accountant to investigate the records, who in his report dated October 5, 1994, has stated that investigation of the accounts with respect to misfeasance could not be made unless the books of account and the other records of the company were made available. It was in these circumstances that the official liquidator filed the present application.

2. I have heard Shri G.K. Garg, learned senior counsel for the applicant assisted by Shri Gaurav Sharma on behalf of the official liquidator and Shri V.L. Mathur, learned counsel for the respondent.

3. Shri G.K. Garg, learned senior counsel for the applicant submitted that the winding up order was passed on the own request of the directors of company as voluntary winding up and that Shri R.M. Khandelwal, the chartered accountant was appointed on their own request for preparing the statement of affairs. He had to prepare report on the basis of whatever records were available. As no records for the period dated January 1, 1988 to November 3, 1989, were made available, in absence of that, it cannot be said that the statement of affairs prepared by him were having full particulars or gave true picture of assets and liabilities of the company. This fact has been proved by Shri R.M. Khandelwal, the chartered accountant in his affidavit/statement made before this court. M/s. N.C. Jain and Associates, the chartered accountant was appointed to investigate the accounts with respect to misfeasance, etc. He also in his report dated October 5, 1994, clearly stated that it was not possible for him to carry out the examination of books of account of company inasmuch as the ex-directors have not given charge of complete records of books of account, namely; the cash book, ledger, journal, bank book, asset register, bank statement of accounts, vouchers, etc., both of its headquarters and also for the 32 branches. The absence of so bulky record was the precise reason for preparing defective statement of affairs. Shri N.C. Jain has also in his affidavit before this court proved all these facts. Due to absence of records, it was not possible for the official liquidator to find out the exact instances of the misapplication or misfeasance. The ex-directors of the company are also guilty of retaining the records relating to both movable or immovable assets for which he has no information.

4. Shri G.K. Garg, learned senior counsel for the applicant submits that as per the statement of affairs prepared by Shri R.M. Khandelwal, it is evident that cash balance with the company as on December 31, 1987, was Rs. 3,62,530.82. There is no balance-sheet prepared after December 31, 1986. Besides, the said amount of cash balance has not been accounted for by the respondents. There were 32 branches of the company in the State of Rajasthan and Gujarat. The ex-directors did not make the books of account and other properties of such

branches available to the petitioner as per the statutory requirement of section 454 of the Act. Learned senior counsel especially invited attention of the court towards the detailed affidavit and cross-examination of Shri B.C. Meena, the official liquidator examined as PW 1 before this court.

5. Shri G.K. Garg, learned senior counsel disputed that respondent No. 3 resigned or that respondents Nos. 1 and 2 were not responsible for accounting for the cash, producing records and surrendering vehicle. Respondent No. 3 filed a brief that he resigned. As per the records maintained by the Registrar of Companies, Jaipur, respondent No. 3-Rakesh Srivastava was one of the directors of the said company as on the date of passing of the aforesaid winding up order. Respondent No. 3, in response to the notice of the official liquidator, claimed that he tendered his resignation long ago and the same was accepted by other director of the company Smt. Kusum Sinha. As per the information obtained by the official liquidator from the Registrar of Companies, however, he still continued as director. Neither he appeared as witness, nor has specified his defence, nor placed on record the certificate of the company or general rules and Form 56 as required under sections 303/305 and 306 of the Companies Act. The fact about the alleged resignation of respondent No. 3 has been refuted by the other two respondents, i.e., Shri D.D. Sinha and Smt. Kusum Sinha, who in their counter affidavit/cross-examination have maintained that respondent No. 3 continued to be director of the company and did not resign. They have stated that respondent No. 3 was very much director of the company and therefore, it is argued that respondent No. 3 cannot escape from liability.

6. Shri G.K. Garg, learned senior counsel in support of his arguments has relied on the judgment of the Karnataka High Court in Shivmoni Steel Tubes Limited (In Liquidation), Bangalore Vs. A. Murali, the judgment of the Gujarat High Court in Official Liquidator of Dhavalgiri Paper Mills Pvt. Ltd. Vs. Chinubhai Khilachand and Others, and judgment of the Calcutta High Court in Jameshedpur Cements Ltd. (In Liquidation) and Mr. Baldev Raj Taneja Vs. The Official Liquidator, .

7. Shri V.L. Mathur, learned counsel appearing for the respondents has argued that originally when the company was incorporated on November 8, 1985, Shri Vijay Kumar Kaushal, Shri Rajesh Shrivastava and Mrs. Shyama Shrivastava were the directors. After retirement of Smt. Shyama Shrivastava, Shri Raisuddin Qureshi became the director and remained as such up to the date of filing of the present writ petition. He has not even been impleaded as the party-respondent. Shri Rakesh Shrivastava has resigned on September 28, 1988. He was in full time employment elsewhere and never took active part in the affairs of the company. Shri Vijay Kumar Kaushal, another director unfortunately died in road accident on January 4, 1988. Shri D.D. Sinha and Smt. Kusum Sinha, widow of Vijay Kumar, became directors on January 8, 1988. Smt. Kusum Sinha was given cash balance of only Rs. 2,667. Entire record was gathered from different branches and were handed over to the official liquidator. Respondents Nos. 1 and 2 after they became directors on January 8, 1988, did not transact any business

of the company till the presentation of winding up petition of the company on October 7, 1988. In fact, the banker of the company, i.e., the State Bank of Bikaner and Jaipur, Tilak Marg, Jaipur did not allow them to operate bank account of the company. The amount of Rs. 5,64,000 that was lying/deposited in their account was still in the bank account. The voluntary winding up order was passed on November 3, 1989, under section 457. The official liquidator had power to summon the records from various branches and in fact it was his duty to do so. If he has failed to summon the record and collect the record from different branches, the respondents cannot be blamed for the same.

8. It is argued that Shri R.M. Khandelwal, chartered accountant appointed by the court prepared the statement of accounts based on the records up to December 31, 1987 and he had shown cash balance of Rs. 3,62,530.83. No efforts were made to recover the amount from the employees of the company as respondents Nos. 1 and 2 became directors belatedly on January 8, 1988. The statement of Shri R.C. Mishra, the then official liquidator was recorded on December 15, 2009, who neither in the statement, nor in cross-examination, has pointed out any specific act of misfeasance against any of the directors. Similarly, Shri N.C. Jain, the chartered accountant has also not in his statement, disclosed any act of misfeasance, nor any such act has been pointed out by Shri N.C. Jain in his report dated October 5, 1994. This report, in fact, lacks in specific instances. In fact, he has shown his helplessness to prepare the report unless the books of account and other records of the company would be available. Lack of evidence cannot be taken as substitute of proof. The official liquidator has therefore miserably failed to prove the act of misfeasance against any of the directors. The application under section 543(1) of the Companies Act is liable to be dismissed with cost. Shri V.L. Mathur, learned counsel for the respondents in support of his arguments has relied on the judgments in *Official Liquidator of Shield Shoe Company P. Ltd. (In Liquidation) Vs. Fateh Chand Pahwa and Others*, and judgment in *Shivmoni Steel Tubes Limited (In Liquidation), Bangalore Vs. A. Murali*, and *Official Liquidator of Dhavalgiri Paper Mills Pvt. Ltd. Vs. Chinubhai Khilachand and Others*, and *Jameshedpur Cements Ltd. (In Liquidation) and Mr. Baldev Raj Taneja Vs. The Official Liquidator*, .

9. Before embarking upon the merits of the case, this court, in view of the kind of the material produced on record to bring home the guilt of the respondent-directors, deems it appropriate to examine the position of law as to in what circumstances, director and for that matter, the ex-director of the company in liquidation, can be held guilty of misconduct, misappropriation, misapplication, misfeasance or breach of trust. Reference in this connection may be made to the judgment of the Supreme Court in *The Official Liquidator Vs. Raghawa Desikachar and Others*, . The Supreme Court in that case held that the application filed for the purpose should contain the detailed narration of the specific acts of commission and omission on the part of each director quantifying the loss to the company arising therefrom. The burden of proving misfeasance or non-misfeasance rests on the official liquidator.

10. In P.K. Nedungadi Vs. The Malayalee Bank Ltd. (In Liquidation) and Others, , also it was held by the Supreme Court that if the money or the property of the company has been misapplied or there has been misfeasance or breach of trust in relation to the company by a director, the court after examining the matter, can compel an officer or other persons mentioned in section 543 to repay or restore the property with interest at such rate as the court may think fit or to contribute such sums to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust, as it thinks fit. The Supreme Court in that case also held that misfeasance and breach of trust include a breach by a promoter, director, etc., of a duty of the company the direct consequence of which has been a misapplication or loss of its assets for which he could be made responsible in an action. Allegations or proof of fraud are not essential and it is immaterial that the offence is one for which the offender may be criminally liable.

11. The Supreme Court in yet another judgment in Official Liquidator, Supreme Bank Ltd. Vs. P.A. Tendolkar (Dead) by Lrs. and Others, , held in paragraph 40 as under (page 400):

"It is certainly a question of fact, to be determined upon the evidence in each case, whether a director, alleged to be liable for misfeasance, had acted reasonably as well as honestly and with due diligence, so that he could not be held liable for conniving at fraud and misappropriation which takes place. A director may be shown to be so placed and to have been so closely and so long associated personally with the management of the company that he will be deemed to be not merely cognizant of but liable for fraud in the conduct of the business of a company even though no specific act of dishonesty is proved against him personally. He cannot shut his eyes to what must be obvious to everyone who examines the affairs of the company even superficially. If he does so he could be held liable for dereliction of duties undertaken by him and compelled to make good the losses incurred by the company due to his neglect even if he is not shown to be guilty of participating in the commission of fraud. It is enough if his negligence is of such a character as to enable frauds to be committed and losses thereby incurred by the company."

12. In Union of India (UOI) Vs. S.P. Mathur, , in a proceeding under section 543 of the Companies Act on allegation of negligence, misfeasance or breach of trust against the ex-directors of the company in liquidation, it was held by the Allahabad High Court that even if the directors have not misapplied or retained the properties and it is proved that they have acted in reckless manner without taking care of statutory requirement and applying basic common sense in sanction of the amounts, which could not be recovered, such directors commits misfeasance.

13. The Gujarat High Court in Official Liquidator, Aryodaya Ginning and Manufacturing Mills Ltd. Vs. Gulabchand Chandalia, , held that the liability which is enforced under section 543 is a liability in the nature of tort or a liability in the

nature of quasi-criminality and is founded on principle that the director; who has caused loss to the company by an act, which amounts to misappropriation, breach of trust, misapplication or retention, should make good the loss. It provides a summary remedy to determine the amount payable by such director. The section thus provides a speedy remedy of payment of compensation to the company in respect of loss occasioned to the company by the misfeasance of the delinquent director. A misfeasance claim against the company officers is capable of covering the full range of duties owed by a director to a company and is not restricted to ethical or fiduciary duties. Only misfeasance resulting in loss to the company will come under the section. Mere negligence or neglect of duty unless loss has resulted by reason of it, will not create any liability. It was held that if a company suffers any loss on account of negligence on the part of director, he is liable to reimburse the company to the extent of such loss.

14. The Calcutta High Court in *In Re: National Sugar Mills Ltd. (In Liquidation)*, , has held that it is clearly a question of fact to determine on evidence whether a director alleged to be liable for such misfeasance, has acted reasonably as well as honestly and with due diligence so that he could not be held liable for conniving at fraud or misapplication of the fund of the company. But if a director is shown to be so placed that he has been closely and personally associated with the management of the company before funds have been misapplied then he will be deemed to be only cognizant but liable for fraud or misappropriation of the funds of the company if there is a loss, even though no specific act of fraud or dishonesty is proved against him for such loss.

15. This court in *Jaipur Vastra Vyopar Sangh Ltd. (In liquidation) and Another Vs. Shyam Sunder Lal Patodia*, ; AIR 1970 Raj 91, on an application under section 543 based on the alleged misconduct of a past or present director, managing agent, etc., held that by the express wordings of the section, the right to present such application does not vest in the company, but in the official liquidator, liquidator, or any creditor or contributory of the company. This has to be so because the purpose of the application is to ensure that any past or present director, or managing agent, etc., having a controlling interest in the company may not be able to evade his liability either by the weight of his influence in the affairs of the company or by pleading that under the law it is only the company which has the right to sue and no one else. Even if action by way of a suit is found to be barred by the law of limitation in any particular case, the remedy by an application under section 543 of the Companies Act is still available to the official liquidator if the extended period of limitation prescribed by the section happens to be available to him.

16. The Calcutta High Court in *In Re: Central Calcutta Bank Ltd.*, , held that in order to appreciate the case within the purview of section 543, it is essential to establish that there has been a breach of trust and that the breach has resulted in pecuniary loss to the company. The Calcutta High Court in *In Re: Indo Burma Industries Ltd.*, , held that the order "misfeasance" in section 235 has not been

defined. The counter part of the English Companies Act making similar provisions of misfeasance has been judicially noticed on a number of occasions. The section rather acquired description of being called a "misfeasance section". This section covers many acts other than misfeasance like misapplication or any money or property of the company or liability or accountability for any money or property of the company in addition to any act of misfeasance or breach of trust. The Calcutta High Court in *Jameshedpur Cements Ltd. (In Liquidation) and Mr. Baldev Raj Taneja Vs. The Official Liquidator*, has held that if any loss is caused to the company, all its directors will not automatically become liable, unless the allegation of misfeasance is made and proved against the director indicating his connection with such loss. The Karnataka High Court in *Shivmoni Steel Tubes Limited (In Liquidation), Bangalore Vs. A. Murali*, has held that charge of misfeasance against a director is a serious charge of misconduct or misappropriation or breach of trust. It is incumbent on the official liquidator to furnish the details of the said act. The averments must disclose the cause of action. That was a case in which the petitioner was appointed on the board of directors of the company on September 17, 1990, when the number of directors on the board fell below the minimum permissible in the case of a public company, i.e., three. The company was ordered to be wound up by the court on September 8, 1995. It was clear from the records of the company that the company had had no transactions at all from 1987 onwards, until it was ordered to be wound up. The balance-sheet of the company contained an entry as on December 31, 1995, relating to National Savings Certificates amounting to Rs. 55,150. In those facts, it was held by the court that there was absolutely no material to show that any transaction took place between August 20, 1990 and September 8, 1995. On the contrary, it was common ground between the parties that no transactions took place during that period when the respondent was a director of the company. Therefore, the application was held to be an abuse of the process of the court and was dismissed in limine.

17. Considering the present matter in the light of the law discussed above, it is noted that when the company was originally incorporated on November 8, 1985, Vijay Kumar Kaushal, Rajesh Shrivastava and Mrs. Shyama Shrivastava were the original directors. After retirement of Smt. Shyama Shrivastava, Shri Raisuddin Qureshi became director and continued as such till the date of presentation of the winding up petition. Shri Rakesh Shrivastava claims to have resigned from the company on September 28, 1988, whereas the official liquidator has disputed such assertion contending that he never appeared in the witness box to substantiate the said defence, nor placed on record Form 34 of the Companies (Central Government's) General Rules and Forms, 1956 as required by sections 303(2), 305 and 306 of the Companies Act, 1956. Even if therefore we proceed on the assumption that he did not resign, yet the official liquidator is required to specifically allege the negligence on the part of each of the directors. The allegation of misfeasance and misapplication has to be specifically pleaded with material particulars against each of the directors/erstwhile directors of the

company. It is necessary that specific acts of commission or omission and/or negligence on the part of each director are pointed out and it is shown that the loss suffered by the company was result of such omission, commission or negligence. It is only then that the loss can possibly be quantified as the order of recovery of such loss shall have to be directed against such or any of the directors.

18. The liability under the provisions of section 543 though in the nature of tortious liability, yet it is quasi-criminal in nature and therefore the recovery can be directed to be made from a director, who is held liable for causing loss to the company by his act or omissions, which tantamount to misappropriation, breach of trust, misapplication or retention of monies/properties of the company. For an allegation of this nature, onus is always on the person who alleges such acts of misfeasance and such onus shall be discharged by him by cogent, reliable and specific evidence which should prove that the alleged misconduct was willful and amounted to misfeasance with culpable negligence. But here a caveat has to be lodged that not all acts which result in loss to the company can be treated as misfeasance because while carrying business, there is every likelihood that loss may be incurred in a transaction or number of transactions. If therefore any loss is caused to the company, all its directors may not thereby automatically become jointly and severally liable therefor. The meaning of misfeasance is the improper performance of some act for the purpose of section 545, which a person may lawfully do. In other words, it should be such a director while carrying out an activity is otherwise empowered to carry out under the law, but performs it in such a manner that the same is improper and such impropriety has to be willful so as to cause loss to the company.

19. The allegation of misfeasance has to be therefore pleaded and proved against each of the directors) or erstwhile director(s) indicating thereby that such act or omission on his part has led to the loss caused to the company or that such loss resulted from his act or omission. If such connection is proved, then only it can be held that loss of the nature contemplated in the misfeasance proceedings is caused to the company by that particular director subject of course to his right of rebuttal.

20. As regards the present case, it was a case of voluntary winding up of the company and not at the instance of any of its creditors. And here, it may be noted at the cost of repetition that Shri Vijay Kumar Kaushal, Shri Rajesh Shrivastava, Smt. Shyama Shrivastava were the directors of the company when it was originally incorporated on November 8, 1995, but after retirement of Smt. Shyama Shrivastava, Shri Raisuddin Qureshi became director and remained till the date of presentation of winding up petition. The official liquidator has failed to implead him as party-respondent. While Shri Rakesh Shrivastava has asserted that he resigned as director of the company on September 28, 1988 and that he was in full time employment elsewhere and never took part in the affairs of the company. Shri Vijay Kumar Kaushal, the original director died in road accident on

January 4, 1988. It was after his death that his widow Smt. Kusum Sinha and one Shri D.D. Sinha became directors on January 8, 1988. The respondents have demanded the accounts of the company. Smt. Kusum Sinha was given cash balance of Rs. 2,667 when these two directors were newly appointed and that the other money that was shown to have been in the hands of different branches was never recovered except the amount of Rs. 5,64,000 which was lying in the company bank account with the State Bank of Bikaner and Jaipur, Tilak Marg, Jaipur, which is still lying there. It is a question of fact to determine from the evidence whether a director alleged to be liable for misfeasance has acted reasonably as well as honestly and with due diligence. The nature of the assertions made and the evidence produced, therefore, does not bring the allegations against the respondents within the purview of misfeasance or misapplication or breach of trust. It is true that a director is always expected to act reasonably as well as honestly and with due diligence, but it is a question of fact, which has to be determined on evidence whether he can be held liable for misfeasance, having not acted reasonably and honestly and with due diligence. Besides, it has also to be proved that such director was so liable because he has been personally associated with the affairs of the company around the time when its funds have been misapplied so that it can be deemed that he was cognizant about the transaction of the company. Even though it may not be necessary to prove against him the allegation of fraud or misappropriation, yet it has been shown that he, by virtue of close association in the working of the company, had shut his eyes and allowed the misappropriation of the funds of the company. He neglected in duty to look after the affairs of the company as a man of ordinary prudence and thereby allowed the misappropriation of the funds of the company. In the facts of this case, mere absence of books of account cannot by itself be taken to prove such allegations against the respondents because so far as Smt. Kusum Srivastava and Shri D.D. Sinha are concerned, they were made directors on January 8, 1988, only after Shri Vijay Kumar Kaushal died in a road accident on January 4, 1988, whereafter no business was transacted by the company. And Shri Rakesh Shrivastava, besides his plea of resignation, is shown to be in full time employment elsewhere and was not actively associated in the affairs of the company. The company applied for voluntary winding up and such order was passed by this court on November 3, 1989. There is no evidence that company had been having any business or activities between the year 1988 and 1999.

21. In the circumstances, therefore, the petitioner cannot be said to have proved the ingredients of section 543 of the Companies Act, necessary for holding the respondents-erstwhile directors of the company guilty of misfeasance, misapplication, breach of trust or retention of the money of the company. The company application is therefore dismissed.