

(2007) 11 MAD CK 0194

In the Madras High Court

Case No : C.A. No. 609 of 2005 in C.P. No. 365 of 1997

Official Liquidator, High Court

APPELLANT

Vs

Gautham Dhiraj Mal Ranka and Others
Ltd. Vs Mangal Processing Mill Ltd.

RESPONDENT

Date of Decision : 07-11-2007

Acts Referred:

Companies Act, 1913 — Section 235

Companies Act, 1956 — Section 283(1), 460(4), 542, 542(1), 543

Citation : (2008) 141 CompCas 129 : (2008) 2 CompLJ 90 : (2008) 83 SCL 547

Hon'ble Judges : S. Rajeswaran, J

Bench : Single Bench

Final Decision : Dismissed

Judgement

S. Rajeswaran, J.—This application has been filed to examine the conduct of the respondents known as the ex-directors of the company in

liquidation in terms of Sections 542 and 543(1) of the Companies Act, 1956, and order that they are jointly and severally liable to contribute to the

assets of the company in liquidation by way of compensation for the loss caused by them to the company in liquidation to the extent of Rs.

13,84,13,871.36 (rupees thirteen crores eighty four lakhs thirteen thousand eight hundred and seventy one and paise thirty six only) and the future

claims from the creditors with interest at the rate of 12 per cent, per annum thereon from the date of winding up, i.e., from April 7, 2000, till the

date of recovery of the entire amount:

(c) declare that the respondents herein are personally liable/responsible without any limitation of liability for all the debts and other liabilities of the

company in liquidation.

(d) declare the liabilities of respondents Nos. 1 to 5 for the said sum of Rs. 13,84,13,871.36 (rupees thirteen crores eighty four lakhs thirteen

thousand eight hundred and seventy one and paise thirty six only) and future claims of the creditors together with interest thereon shall constitute the

first charge on the property and effects in their possession.

(e) direct the respondents to pay the applicant the cost and incidental expenses of these proceedings.

(f) permit the official liquidator to engage the services of a senior Counsel of the Madras Bar to conduct this case on behalf of the official liquidator.

(g) allow the official liquidator to place/accept further facts at the time of hearing this case.

(h) permit the official liquidator to meet the cost of this application and the cost of engaging a senior Counsel and other costs from the funds of the

company and if it is insufficient may be borne from the Common Establishment Charges Account.

2. This application has been filed by the official liquidator under Sections 460(4), 542 and 543 of the Companies Act, 1956. In the report dated

April 5, 2005, filed in support of the above application, the official liquidator has stated that by an order dated April 7, 2000, made in C. P. No.

365 of 1997, this Court ordered the company in liquidation to be wound up. Respondents Nos. 1 to 5 herein are the ex-directors of the company.

Pursuant to taking possession of the available assets of the company in liquidation the moveables were sold on the basis of the order dated

September 26, 2003, in C.A. No. 1319 of 2002 for a sum of Rs. 5,21,000. When the immovable assets were brought for sale by the official

liquidator, no offer was made and this Court directed the secured creditor bank to bring prospective buyers.

3. As the ex-directors failed to file the statement of affairs within the time stipulated, the official liquidator filed C. A. No. 2559 of 2000 and this

Court while disposing of the application permitted the ex-directors to peruse the books of account and to file the statement of affairs. Accordingly,

the ex-directors filed the statement of affairs on January 8, 2003.

4. After going through the statement of affairs, the official liquidator found that the ex-directors acted against the interest of the company,

conducted the business contrary to the provisions of the Companies Act and

failed to account for to the liquidator. Accordingly, the official liquidator framed four charges in his report namely: (1) a sum of Rs. 13,35,512 shown as assets not specifically pledged were not handed over nor relevant documents were produced before the official liquidator; (2) even though the ex-directors have shown the value of moveable assets at Rs. 10,59,01,777, the moveables handed over by them fetched only a sum of Rs. 5,21,000; (3) The ex-directors have not furnished the details of debts nor stated whether any recovery proceedings are being taken to recover the debts, when they have shown a sum of Rs. 28,94,488 in trade debtors category and a sum of Rs. 15,69,639 in loans and advances; and (4) the amount of Rs. 2,71,06,248.36 shown in unsecured creditors category accrued due to the maladministration and mismanagement of the ex-directors. Hence, the above application has been filed by the official liquidator.

5. A counter-statement has been filed by respondents Nos. 1 to 3. It is stated in the counter-statement that the application filed under Sections 542 and 543 of the Companies Act, 1956, is not maintainable as the report of the official liquidator does not disclose any material particulars of the purported instances of breach of trust and misfeasance committed by respondents Nos. 1 to 3.

6. According to them, in spite of their best management, the company went into liquidation because of recession uplifting the cotton industry and the hostile attitude of the secured creditor bank. In fact, it was pointed out in the counter that the first respondent was awarded the Udyog Patra Award and Shri Rajiv Gandhi Memorial Award in 1995 in recognition of his entrepreneurial abilities. Only after realising that it would not be feasible to run this company without incurring loss, they took the decision to effect a closure in 1998.

7. In so far as the four charges framed by the official liquidator are concerned, it is stated that the entire assets and the books of account were handed over to the official liquidator and the sums representing the assets not specifically pledged were not recoverable as the major portion was appropriated by the banks towards interest, TDS and other deposits. The respondents assert that the value of the plant and machinery and other assets are correctly valued and they refer to the certificate of the operating

agency certifying the value of net block of assets at Rs. 1046.25 lakhs

before the BIFR. In so far as the trade debtors and loans and advances are concerned, the diligent efforts in pursuing the various creditors for the

return of the sums due to the company proved futile. They further contend that the failure of the directors to ensure recovery of sums due to the

company will not amount to an act of misfeasance. Hence, they prayed for dismissal of the application.

8. A separate counter-affidavit has been filed by the fourth respondent, wherein also the maintainability of the application under Sections 542 and

543 of the Companies Act is questioned as according to him he was a nonfunctional director of the company for a brief period only. In fact he

joined the I.A.S. in 1968 and worked in West Bengal cadre. He took voluntary retirement in 1989 and set up a consultancy organisation in

Chennai to help exporters and importers in their trade activity. He had never participated actively in the functioning of the company on a daily

basis. Due to his pre-occupation with other assignments, he had absented himself for more than three consecutive meetings of the board and had

ceased to hold office u/s 283(1)(g) of the Companies Act. He prayed for the dismissal of the application as the application is lacking in material

particulars and it does not disclose any purported misfeasance against him.

9. Heard the learned assistant official liquidator and the learned senior Counsel for respondents Nos. 1 to 4. I have also gone through the

documents and judgments referred to in support of their submissions.

10. Learned senior Counsel for respondents Nos. 1 to 4 submitted that the application filed under Sections 542 and 543 is to be rejected as there

is no specific allegations of dishonesty misappropriating the funds and thereby illegally enriching themselves by the directors. The allegations levelled

are only general in nature and in such circumstances, Sections 542 and 543 cannot be invoked. Learned senior Counsel submitted even on the

merits that the ex-directors could not be personally held liable as in spite of their best management, the company went into liquidation.

I have considered the rival submissions with regard to facts and citations.

First let me consider the decisions relied on by the learned senior Counsel for the respondents to cull out the legal principles that have been

enunciated with regard to Sections 542 and 543 of the Companies Act.

11. In *The Official Liquidator Vs. Raghawa Desikachar and Others*, , the hon''ble Supreme Court held a misfeasance application against the

directors being a serious charge of misconduct or breach of trust. The application by the official liquidator should contain a detailed narration of the

specific acts of commissions and omissions and the burden of proving misfeasance or non-feasance rests on the official liquidator. The relevant

paragraph of the judgment read as under (page 142):

7. The above proceedings clearly show that no opportunity was given to respondents Nos. 1 to 4 because proceedings of January 12, 1958, show

that as soon as written statement was filed on December 30, 1957, the district judge fixed the case for argument. The proceedings of July 7, 1958,

further show that Mr. Amin had brought to the notice of the official liquidator that he should be supplied with materials on which the official

liquidator would rely for the alleged malfeasance on the part of his clients, but no materials were furnished by the official liquidator. Accordingly, on

the second hearing after the aforesaid application, a petition for submitting fresh evidence and for cross-examining respondent No. 5 was made but

it was rejected. The show-cause notice was given by the official liquidator on the basis of the public examination of respondents Nos. 1 to 4. It is

only in answer to the show-cause notice that respondents Nos. 1 to 4 could lead evidence and cross-examine respondent No. 5. It may be

mentioned that misfeasance action against the directors is a serious charge. It is a charge of misconduct or misappropriation or breach of trust. For

this reason the application should contain a detailed narration of the specific acts of commission and omission on the part of each director

quantifying the loss to the company arising out of such acts or omissions. The burden of proving misfeasance or non-feasance rests on the official

liquidator. The official liquidator, it may be mentioned, merely relied upon the evidence recorded in public examination of the directors and on a

few documents tendered in evidence. At the stage of public examination's there was no charge of misfeasance against the directors and they were

not in a position to know what would be the grounds that would be alleged against them for recovering any amounts for the loss said to have been

caused to the company by reason of such misfeasance. The application made by the official liquidator did not give sufficient particulars which, in

our view, it should have. Once a show-cause notice was given to respondents Nos. 1 to 4 the official liquidator did not lead any evidence nor rely upon any other documents, nor did respondent No. 5, who was instrumental in initiating the misfeasance case against respondents Nos. 1 to 4, lead any evidence. In our view, there was no justification whatsoever for the district court to reject the evidence which the respondents had intended to lead or to disallow the production of documents other than those already produced, and for that reason the High Court rightly ordered that additional evidence be recorded in this case.

12. In *Security and Finance P. Ltd. v. B.K. Bedi* [1991] 71 Comp Cas 101, the Delhi High Court held that in an application under Sections 542

and 543 of the Act, if there are no specific allegations against any specific director, the application to be dismissed in so far as that director is

concerned. The relevant passage reads as under (pages 119 to 123):

Sections 542 and 543 of the Act read as under:

542. Liability for fraudulent conduct of business.--(1) If in the course of the winding up of a company, it appears that any business of the company

has been carried on, with intent to defraud creditors of the company or any other persons, or for any fraudulent purpose, the court, on the

application of the official liquidator, or the liquidator or any creditor or contributory of the company, may, if it thinks it proper so to do, declare that

any persons who were knowingly parties to the carrying on of the business in the manner aforesaid shall be personally responsible, without any

limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct.

On the hearing of an application under this sub-section, the official liquidator or the liquidator, as the case may be, may himself give evidence or call

witnesses.

(2)(a) Where the court makes any such declaration, it may give such further directions as it thinks proper for the purpose of giving effect to that

declaration.

(b) In particular, the court may make provision for making the liability of any such person under the declaration a charge on any debt or obligation

due from the company to him, or on any mortgage or charge or any interest in any mortgage or charge on any assets of the company held by or

vested in him, or any person on his behalf, or any person claiming as assignee from or through the person liable or any person acting on his behalf.

(c) The court may, from time to time, make such further order as may be necessary for the purpose of enforcing any charge imposed under this sub-section.

(d) For the purpose of this sub-section, the expression ""assignee"" includes any person to whom or in whose favour, by the directions of the person

liable, the debt, obligation, mortgage or charge was created, issued or transferred or the interest was created, but does not include an assignee for

valuable consideration (not including consideration by way of marriage) given in good faith and without notice of any of the matters on the ground

of which the declaration is made.

(3) Where any business of a company is carried on with such intent or for such purpose as is mentioned in Sub-section (1), every person who was

knowingly a party to the carrying on of the business in the manner aforesaid, shall be punishable with imprisonment for a term which may extend to

two years, or with fine which may extend to five thousand rupees, or with both.

(4) This Section shall apply, notwithstanding that the person concerned may be criminally liable in respect of the matters on the ground of which the

declaration is to be made.

543. Power of court to assess damages against delinquent directors, etc.--(1) If in the course of winding up a company, it appears that any person

who has taken part in the promotion or formation of the company, or any past or present director, manager, liquidator or officer of the company-

(a) has misapplied, or retained, or become liable or accountable for, any money or property of the company; or

(b) has been guilty of any misfeasance or breach of trust in relation to the company,

the court may, on the application of the official liquidator, or the liquidator, or of any creditor or contributory, made within the time specified in that

behalf in Sub-section (2), examine into the conduct of the person, director, manager, liquidator or officer aforesaid, and compel him to repay or

restore the money or property or any part thereof respectively, with interest at such rate as the court thinks just or to contribute such sum to the

assets of the company by way of compensation in respect of the misapplication,

retainer, misfeasance or breach of trust, as the court thinks just.

(2) An application under Sub-section (1) shall be made within five years from the date of the order for winding up, or of the first appointment of

the liquidator in the winding up or of the misapplication, retainer, misfeasance or breach of trust, as the case may be, whichever is longer.

(3) This Section shall apply notwithstanding that the matter is one for which the person concerned may be criminally liable.

In my view, there is no need to treat the present application as one u/s 633 of the Act. Depending upon the facts and circumstances of a case and

to meet the ends of justice and/or to prevent the abuse of the process of court, the court can drop proceedings under Sections 542 and 543 of the

Act or dismiss such an application against any party to the proceedings at any stage....

Under Section 542 of the Act, the courts may declare that any person, who was knowingly a party to the carrying on of the business of the

company, which was carried on with an intent to defraud its creditors or other persons, or was for fraudulent purpose, is personally responsible,

without any limitation of liability, for all or any of the debts or other liabilities of the company. It must be shown that the business of the company

has been carried on with an intent to defraud creditors of the company or any other person or for any fraudulent purpose. Further, that the person

who is being made liable was knowingly a party to the carrying on of the business for fraudulent purpose. Under law, the particulars of fraud must

be given in the application so as to afford an opportunity to that person to meet the allegation. Dishonesty is an essential ingredient of fraudulent

conduct of business. Hence, the pleadings must be specific with regard to the alleged delinquency of a director. The words "any person who was

knowingly a party to the carrying on of the business in the manner aforesaid" are very significant and the intention of the Legislature is very clear in

inserting these words. Mere vague and general allegations are not sufficient to meet the requirement of this section, because the court has come to

the conclusion that the business of the company was carried on with an intention to defraud the creditors and/or for any fraudulent purpose.

Further, that the person against whom the allegations are made was knowingly a party to the carrying on of such business. If the allegations are not

specific and details of fraud are not given, then, the court cannot indulge in a fishing or roving enquiry. Thus, the enquiry, therefore, is to be

confined to the purpose with which the business of the company had been carried on and about the persons who were knowingly parties to such

carrying on of the business.

Under Section 543 of the Act, the court is vested with jurisdiction to examine the conduct of the past or present director, manager, liquidator or

any other officer of the company to find out whether he has misapplied or retained or become liable or accountable for any money or property of

the company; or he has been guilty of any misfeasance or breach of trust in relation to the company and, where any such conduct is found

attributed to any such person, then, to compel him to repay and restore the money or property, or any part thereof to the company. In other

words, under this section, the court is to examine the conduct of an individual director or officer and to pass an order against him, if such a person

is personally found to be liable for misapplication, etc., of the money or property of the company or, otherwise, is guilty of any misfeasance or

breach of trust in relation to the company. It is thus clear that, to enable the court to examine the conduct of an individual director or officer and to

pass an effective order to make him personally liable for misapplication, etc., of the money or the property of the company, there has to be positive

and specific evidence and pleadings in respect of the individual director of an act of the nature contemplated by the section. In the absence of such

specific allegations and positive evidence, it is not possible or proper for the court to indulge in a fishing or roving enquiry so as to compel the

individual director to reimburse and/or compensate the company. The principles with regard to the pleadings and proof are well-settled. There

cannot be a general and roving enquiry into the conduct of a person sought to be made liable.

As held in *In Re: Central Calcutta Bank Ltd.*, , the general principle of liability of joint tort-feasors cannot apply to misfeasance proceedings and, in

order that a person may be a joint tort-feasor, there must be a common design and a concerted action.

I am in respectful agreement with Official Liquidator, Milan Chit Fund and Finance P. Ltd. Vs. Joginder Singh Kohli and Others, , that where, in an

application under Sections 542 and 543 of the Act, there are no specific allegations made against any specific director, the application can be dismissed in so far as that director is concerned.

13. In *Faridabad Rubber Soles P. Ltd. (in liquidation) v. S.L. Chopra* [2001] 103 Comp Cas 975, the Punjab and Haryana High Court held that

mere inaction on the part of the directors of the company to recover dues to the company does not amount to misfeasance within the meaning of

Section 543 of the Companies Act, 1956. The relevant paragraph reads as under (page 977):

The contention that has been advanced before me on behalf of the official liquidator is that since the respondent who was the managing director of

the company did not take any steps on behalf of the company to recover the amounts of Rs. 10,97,872.21 and Rs. 57,146.18 which were due

from different parties and allowed the same to become barred by time, his negligence and inaction amounts to misfeasance on his part within the

meaning of Section 543 of the Act and he is, therefore, liable to compensate the company for these amounts. I find no merit in this contention. The

official liquidator has not alleged any fraud or dishonesty on the part of the directors in not recovering the amounts for the company. As per the

statement of account filed by the respondent the aforesaid amounts were due to the company from different parties but the directors including the

respondent took no steps to recover the same and the recovery of the amounts had become barred by time by the time the liquidator took over.

The question that arises is whether the mere fact that a few debts due to the company had been allowed to become barred by time amounts to

misfeasance on the part of the directors. The matter is not *res integra*. A similar matter arose before *Falshaw J.*, in *Kaithal Grain and Bullion*

Exchange Ltd. v. Lachhman Das [1954] 56 PLR 486, where the learned judge relying on the observations of *Jessel M.R.*, in *Forest of Dean Coal*

Mining Co. In re [1878] 10 Ch. D 450, held that mere inaction on the part of the directors to recover the amount does not amount to misfeasance

within the provisions of the Act. The learned judge in that case was dealing with the provisions of Section 235 of the Companies Act, 1913, which

are similar to those of Section 543 of the Act. Moreover, in the instant case, the company premises were locked by the State Bank of Patiala on

July 17, 1982, and the books and the records of the company were inside. The respondent had no access to them. It was in November, 1987, that this Court directed the bank to open the lock and hand over the books to the official liquidator. It was at that time that the statement of affairs could be filed by the respondent. During all this period the ex-directors had no access to the books and could not, therefore, initiate action for recovery of amounts due to the company. In these circumstances, I do not consider that any action is called for against the respondent. The petition is, accordingly, dismissed with no order as to costs.

14. In the light of the above settled legal principles, if the report of the official liquidator dated April 5, 2005, filed in support of the application is considered, it will reveal that the alleged misfeasance and non-feasance are general in nature without pinpointing a specific act of dishonesty and misappropriation on the part of the individual ex-directors. Therefore, on the basis of such general and sweeping allegations, this Court cannot proceed against the respondents under Sections 542 and 543 of the Companies Act. As the report of the official liquidator is found wanting with regard to material particulars and specific acts of commissions and omissions, which are a must to proceed against the ex-directors under Sections 542 and 543 of the Act, I have no hesitation in rejecting this application. In the result, this application is dismissed. No costs.