(2009) 07 MAD CK 0043

In the Madras High Court

Case No : C.A. No. 1549 of 2005 in C.P. No. 138 of 1998

Official Liquidator, High Court APPELLANT

Vs

V. Selvaraj and Others RESPONDENT

Date of Decision : 10-07-2009

Acts Referred:

Companies Act, 1913 — Section 235
Companies Act, 1956 — Section 426, 454, 542, 543, 543(1)

Citation : (2009) 152 CompCas 177 : (2011) 1 CompLJ 269

Hon'ble Judges : P. Jyothimani, J

Bench : Single Bench

Final Decision : Dismissed

Judgement

P. Jyothimani, J.—This application is taken out by the official liquidator to make the respondents who are the ex-directors of the company

under liquidation liable for misfeasance under Sections 542 and 543(1) of the Companies Act, 1956, and also to hold that they are liable jointly

and severally to pay compensation of Rs. 27,85,940 being the loss caused to the company and also the future claims from the creditors with

interest at the rate of 12 per cent, per annum from the date of winding up, viz., September 15, 2000; and to declare that the respondents are

personally liable and that the above liability shall constitute the first charge on the properties and effects in possession of the respondents.

2. By an order dated September 15, 2000, passed in C.P. No. 138 of 1998, the official liquidator was appointed as the provisional liquidator for

M/s. South Point Enterprises P. Ltd., which, is a company under liquidation. The said company was incorporated in the year 1994 having its

registered office originally at Anna Nagar East, Chennai and subsequently at flat

No. A-l, Ashok Aiswaralayam, 13, Habibullah Road, T. Nagar,

Chennai-17, with the share capital of Rs. 60,000. The object of the company was to carry on the business to import, export, buy, sell, etc., the

goods, products, articles, merchandise and machinery and to carry on business and to act as merchants, commission agents, etc., in India or in any

part of the world. On the date of liquidation, the respondents remained as directors of the company.

3. After the liquidation, the ex-directors were directed to file statement of affairs within 21 days. The first respondent filed, the statement of affairs

and from the same, various irregularities were found, viz., in the trade debtors category, a sum of Rs. 97,000 is due from a company but the

address or relevant documents relating to the said company were not furnished to the liquidator. It is stated that with the said company, the

transactions were made in the years 1994-95 and 1995-96 and the ex-directors let the debts to become time barred.

4. In respect of loans and advances category, it was stated that a sum of Rs. 6,99,902 was due to the company from some debtors and the said

transactions pertained to the years 1995-96 and 1996-97 and the ex-directors have not taken any reasonable steps to recover the said amount

and the debt notices issued were returned for want of correct address.

5. Under the unsecured creditor''s category, it was stated that a sum of Rs. 19,89,038 was due by the company to various creditors of the

company and the liability was created due to mismanagement and maladministration of day-to-day affairs of the company by the ex-directors.

6. The second respondent in his counter affidavit has stated that what was stated by him in the statement of affairs in list-E relating to some letters

dated July 10, 2007, September 16, 2007 and September 18, 2007, of the unsecured creditors are all only remuneration received by him and they

are not loans and there was no borrowal or loan from the unsecured creditors and in effect, there are no unsecured creditors at all.

7. It is relevant to point out at this stage that during the course of arguments, the learned official liquidator has also fairly submitted that there are no

unsecured creditors and therefore, the claim of Rs. 19,89,038 is not pressed.

8. In addition to that, it is relevant to note that in respect of the above said letters dated April 10, 2007, September 16, 2007 and September 18,

2007, the concerned persons have given certificates to the effect that the amounts paid by M/s. Afcons Infrastructure Ltd., Col. V.V.M. Muthu,

M/s. L.U. Krishnan & Co., Chartered Accountants and M/s. L.U.K. Consultancy P. Ltd., were all amounts received by the first respondent only

towards remuneration and they were never advanced as loan either to the first respondent or to the company under liquidation. The said

certificates given by those which have been filed in the typed-set of papers would go to show that there are no claim of unsecured creditors.

However, as it is stated earlier, the learned official liquidator has given up the claim in respect of it.

9. In respect of the other head, viz., trade debtors, it is stated that the respondent themselves have taken steps with the addresses available in the

records and the persons who are liable to pay the amount to the extent of Rs. 97,000 have left the places and the respondents were not able to

take any further steps since they are not able to find out the correct addresses. Regarding the head, loans and advances, the same is denied stating

that the company under liquidation has never made any profit and in spite of the efforts taken, they could not recover the amount and therefore,

there is no intentional act or deliberate conduct on the part of the respondents/ ex-directors.

10. It is, the contention of Mr. Murali, learned Counsel for the ex-directors that while there are no unsecured creditors as it was found on facts, in

respect of recovery from third parties who have received money either as trade debts or loans and advances, steps were taken by the ex-directors

with the addresses furnished by the said persons and in spite of the efforts taken, it was not possible to find out the whereabouts of those persons

and, it is not intentional especially in the circumstances that there are no secured creditors of the company and therefore, it cannot be construed as

misfeasance. He would rely upon the judgment of the Delhi High Court in Official Liquidator, Milan Chit Fund and Finance P. Ltd. v. Joginder

Singh Kohli [1978] 48 Comp Cas 357 and the order of this Court reported in Official Liquidator, High Court, Madras v. Gautham Dhiraj Mai

Ranka [2008] 141 Comp Cas 129, to substantiate his contention that misfeasance or non-feasance of general nature without pinpointing the

specific act of dishonesty would not attract the provisions of Section 543(1) of the Companies Act.

11. It is seen in the records placed before this Court that except staring generally that there are trade debtors of the company under liquidation to

the extent of Rs. 97,000 and persons to whom loans and advances were made to the extent of Rs. 6,99,902 that the same related to the

transactions of the years 1994-95 and 1995-96 and that the ex-directors have not taken action to recover the amounts and allowed the debts to

be lapsed by limitation, there are no specific instances or dishonest instances on the part of the ex-directors.

12. Again, in respect of unsecured creditors, on record, it is proved that there are no unsecured creditors of the company and the claims which are

made to the extent of Rs. 19,89,038 have been admitted by the learned official liquidator to be remuneration received by the first respondent,

being one of the directors and not paid to the company under liquidation by way of loan or otherwise.

13. Section 543(1) of the Companies Act makes it very clear that the liability is attributable to the ex-directors only if it is found that the moneys of

the company under liquidation have been misapplied or there has been misfeasance or breach of trust. Section 543 is as follows:

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.

14. The term misfeasance or breach of trust is certainly relatable not only to intentional act of the directors, but also to the deliberate conduct of the

ex-directors which has resulted in the loss to the company under liquidation. Therefore, to constitute misfeasance under the said provision, the

intentional, act or deliberate conduct which is detrimental to the interest of the company under liquidation on the part of the ex-directors is a sine

qua non.

15. Similarly, Section 542 of the Companies Act also relates to the fraudulent conduct of business in which case, on recording evidence or hearing

the parties on the application by the official liquidator, the court can pass orders. At this stage, it is also relevant to note that when the official of the

official liquidator who has chosen to give evidence in this application, has admitted that any ex-director is not specifically stated to be responsible

for the day-to-day affairs of the company in the misfeasance report. It is also stated in the evidence that he has not mentioned in the misfeasance

application that the books of account are available with the ex-directors. It is also stated that he has not specifically mentioned the name of any ex-

director who has mismanaged or misadministered the company in the misfeasance report. It is also stated in the evidence that he cannot state from

misfeasance report that he has specifically mentioned the role of ex-directors of the company and he has also found no defect in the statement of

affairs filed by the first respondent. It is therefore admitted that the misfeasance report itself has been filed on the basis of the statement of affairs

filed by the first respondent being one of the ex-directors and in the statement of affairs he has not found any defect or discrepancy. It is also

admitted that it is correct to state that without specifically mentioning the names of ex-directors, the misfeasance report has been filed generally.

16. In Official Liquidator, Milan Chit Fund and Finance P. Ltd. Vs. Joginder Singh Kohli and Others, , while referring to the contents of the

statement of affairs filed by the ex-director u/s 454 and also with reference to Section 543 of the Companies Act, 1956, the Delhi High Court has held as follows:

16. No specific conduct is attributed to any of these respondents. However, in paragraph 11, it is alleged that a number of members of the

company, including respondent No. 4 had made default in payment of the final call of Rs. 40 per share which was payable by March 31, 1965.

The liability of a member of a joint stock company to contribute to the assets of the company is provided u/s 426 of the Act. The failure to make

the requisite contribution does not appear to attract any of the provisions of Sections 542 and 543 of the Act. The official liquidator is entitled to

take appropriate proceedings to enforce this liability. Counsel for the applicant was unable to show how such a liability could be enforced under

any of the provisions which had been invoked in the present application. The application must, therefore, be dismissed in relation to these two

respondents as well.

17. That was also the view of this Court in Official Liquidator, High Court, Madras v. Gautham Dhiraj Mai Ranka [2008] 141 Comp Cas 129,

wherein S. Rajeswaran, J. under similar circumstances by referring to the judgment of the Supreme Court in The Official Liquidator Vs. Raghawa

Desikachar and Others, , wherein it was held that misfeasance against a director being a serious charge of misconduct or breach of trust, must

contain the detailed narration of specific acts of commissions and omissions and the burden of proof of misfeasance or non-feasance rests on the

official liquidator, has held that if the specific instance of dishonesty or misappropriation of an individual director is not pinpointed and sweeping

and general allegations are made, the same cannot be a ground for this Court to proceed u/s 543 of the Companies Act. In fact, the learned judge

has quoted the judgment of the Delhi High Court in Security and Finance P. Ltd. v. B.K. Bedi [1991] 71 Comp Cas 101, wherein, while dealing

with Sections 542 and 543 of the Companies Act, the Delhi High Court has explained the significance of the words ""any person who was

knowingly a party to the carrying on the business"" as found in Section 542, held that the conduct of the ex-directors cannot be examined under

Sections 542 and 543 of the Companies Act unless there is a positive and specific evidence and pleading against the individual director. The

relevant portion of the judgment of the Delhi High Court has been reproduced by the learned judge of this Court in the above said judgment as

follows:

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.

18. It is further relevant to note that the Punjab and Haryana High Court, while dealing with a case where the allegation made against the director

was general in nature, as found in the present case, in Faridabad Rubber Soles P. Ltd. (in liquidation) v. S.L. Chopra [2001] 103 Comp Cas 975,

held as follows:

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.

19. Therefore, it is clear that when an application under Sections 542 and 543 of the Companies Act is made relating to the allegation of fraud or

breach of trust or misappropriation, to prove such allegation which is being criminal in nature, it is necessary that there should be mens rea aspect

on the part of the ex-director either in committing fraud or causing loss to the company under liquidation. Such conduct of fraud or breach of trust

must be specifically pleaded and proved and in the absence of such specific pleading and proof, on the facts of the present case, it is not possible

to accept the contention of the learned official liquidator that there has been deliberate conduct of fraud or breach of trust on the part of the ex-

directors of the company under liquidation.

20. In view of the abovesaid reasons, I do not see any substance in the

application filed by the official liquidator for taking any further action

against the respondents, viz., ex-directors of the company under liquidation for misfeasance under Sections 542 and 543 of the Companies Act

and therefore, the application stands dismissed.

