

(2005) 11 BOM CK 0036

In the Bombay High Court

Case No : Company Application No. 24 of 1994 in Company Petition No. 2 of 1987

Official Liquidator of John Galt Laboratories Ltd. (in Liquidation)

APPELLANT

Vs

R.B. Sangare and Others

RESPONDENT

Date of Decision : 18-11-2005

Acts Referred:

Civil Procedure Code, 1908 (CPC) — Order 1 Rule 10
Companies Act, 1913 — Section 235
Companies Act, 1956 — Section 2(30), 542, 542(1), 542(2), 543
Limitation Act, 1963 — Section 21

Citation : (2006) 133 CompCas 258 : (2007) 74 SCL 129

Hon'ble Judges : B.P. Dharmadhikari, J

Bench : Single Bench

Advocate : Anjan De, for the Appellant; R.S. Sundaram, for the Respondent

Final Decision : Dismissed

Judgement

B.P. Dharmadhikari, J.—This is application u/s 542 read with Section 543 of the Companies Act, 1956, for taking cognizance of misfeasance against three respondents namely R. B. Sangare, P. P. Joshi, S. N. Bapat in the matter of M/s. John Galt Laboratories Pvt. Ltd. (in liquidation). On August 29, 1989, this court ordered winding up and the present proceedings are filed by the official liquidator on August 17, 1994. This proceedings are filed on the basis of investigation report prepared by chartered accountant M/s. Salve and Company dated April 30, 1994, in which it is mentioned that the company named above was put to loss of Rs. 10,51,714.22 due in negligence and mismanagement of the ex-directors. According to the official liquidator amount of Rs. 4,25,591.03 is the value of stock not handed over to the official liquidator while the amount of Rs. 2,08,153.20 is due from sundry debtors as per the balance sheet as on December 31, 1996, and ex-directors failed and neglected to recover that amount. Objection is also raised to payment of Rs. 2,07,302 on account of

remuneration to directors and in respect of the amount of Rs. 15,446.98 shown as bank balance as per the statement of affairs. Receipt for Rs. 74,914.48 was not entered in the cashbook and the ex-management has shown payment of Rs. 10,000 towards land at MIDC, but the statement of affairs mentions payment of Rs. 30,000 only. It is further contended that the management could not recover advance of Rs. 6,233.95 given to medical representative and other advances of Rs. 31,908.93 as per balance-sheet dated December 31, 1996, and sum of Rs. 42,867.65 towards travelling advance. It is further stated that actual sale price of vehicle of Rs. 5,248 only as per schedule of fixed assets as on December 31, 1986, has not been handed over to the official liquidator it is further stated that the value of furniture and fixtures was shown at Rs. 8,000 while the official liquidator could only realise Rs. 4,000 only. It is contended that the ex-directors failed and neglected in performing the duties and put the company to heavy losses for the sum of Rs. 10,51,714.22 only. It is contended that the directors are personally liable for damages to the company and the said amount needs to be realised through Sections 542 and 543 of the Companies Act, 1956. It is accompanied by the report of the chartered accountant Shri H. P. Salve dated April 30, 1994.

2 On October 11, 1995, the respondents filed Company Application No. 39 of 1995 in the present matter for appropriate directions to the official liquidator and sought an investigation report after considering the accounts for the period from 1986 to 1989. It appears that the chartered accountant Shri Salve prepared the report only up to 1986 though the period stipulated was up to August 28, 1989. On June 27, 1997, the official liquidator filed his reply to this application and stated that the balance-sheet and profit and loss account from 1987 onwards was not furnished and as such, the chartered accountant prepared report only up to 1986, It was further stated that the respondents were only delaying the proceedings. It appears that on August 14, 1998, this court allowed Company Application No. 28 of 1997 and permitted the respondents to file a revised financial statement. In view of the statement, this court granted time to the official liquidator to submit a revised report. On November 22, 1999, the official liquidator filed a supplementary investigation report of the chartered accountant Shri A.G. Pimparkhede. The respondents thereafter filed additional submissions on January 17, 2001, and on October 5, 2001, the official liquidator placed the subsequent report of the chartered accountant on record.

3. On January 14, 2002, the official liquidator placed points of claim on record with reference to the supplementary investigation report. In the report of the earlier chartered accountant the amount was shown as due from ex-directors under 11 heads and in this report it is shown due under 8 heads. Rs. 69,691.66 is shown recoverable on account of travelling advance Rs. 13,230.00 on account of other advance, Rs. 93,425.18 on account of value of stocks. Rs. 1,26,975.39 due from sundry debtors, Rs. 2,07,300 on account of directors remuneration, Rs. 74,914.48 as receipts not entered in books, Rs. 3,500 towards telephone expenses and Rs. 79,732.26 towards sales return and expiry. On September 27,

2002, this court appointed advocate Shri A.R. Sambre as commissioner to record evidence and on September 10, 2003, the commissioner has submitted his report along with evidence. On September 19, 2003, the matter came to be adjourned for final hearing/arguments. The objection in relation to exhibition of certain documents came to be decided on April 21, 2005, and thereafter the parties filed written notes of arguments in October, 2005. The matter was then fixed on October 28, 2005, and came to be adjourned to November 18, 2005.

4. The official liquidator has examined initially the subsequent chartered accountant, one Shri J.S. Dastur, employee of the earlier chartered accountant and himself in support of the claim. The respondents have not cross-examined the official liquidator but they have cross-examined the other two witnesses. Respondent No. 1-R. B. Sangare has examined himself and has been cross-examined. The respondents have not examined anybody else.

5. The official liquidator has filed written notes of arguments contending that the respondents are ex-directors personally accountable for the amount misapplied and also for mismanagement of the company. The total claim amount is mentioned and then reliance has been placed upon the judgment of the hon'ble apex court reported as Official Liquidator, Supreme Bank Ltd. Vs. P.A. Tendolkar (Dead) by Lrs. and Others, . It is stated that there is nothing in the cross-examination of the chartered accountant to disbelieve their reports. Reference is further made to the cross examination of respondent No. 1 to contend that it is the admitted position that there are no supporting bills and vouchers in respect of tours and travels (Rs. 69,691.66), legal expenses (Rs. 13,230). It is contended that custody of stocks of Rs. 64,057.86 and raw materials worth Rs. 29,367.32 was not taken back. Proceedings for recovery of amounts from sundry debtors were not initiated and directors had accepted remuneration of Rs. 2,07,300 contrary to resolution. It is further contended that the amount of Rs. 74,914.48 has been misused as there is no entry in the account books. It is stated that there are no dates submitted in respect of sales return or expiry of goods worth Rs. 79,732.26 only. It is further contended that the ex-directors were negligent and as they did not enter the witness box, adverse inference needs to be drawn against them. Hence direction is sought for making good the loss worth Rs. 6,68,768.97 with interest at 24 per cent, from the date of winding up till recovery.

6 The respondent on the other hand has contended that in the report of the earlier chartered accountant different amount was claimed as loss while in the subsequent report much less amount has been claimed on that account. It is stated that the subsequent report is based on the earlier report only and it is the contention of the respondent that there was no fraud or absence of bona fides to enable the official liquidator to maintain such proceedings against them. It is contended that a substantive error in the subsequent report of Rs. 42,867.65 is already admitted in cross examination by the subsequent chartered accountant. It is contended that the said witness admitted the necessity of legal expenses in

winding up and that he did not make further inquiries from Avion Pharmaceuticals, Thane, and Central Bank of India or with sundry debtors. It is stated that accounts submitted by the respondents have not been looked into by him. It is stated that directors have taken remuneration as per the provision in the memorandum and articles of association of the company. It is further stated that contents of the report submitted by the earlier chartered accountant Shri Salve are not proved though documents are exhibited. It is further contended that the witness for the respondent has stood the test of cross examination and hence, the claim as made needs to be dismissed.

7. At this stage it will be appropriate to refer to the provisions of Section 542 of the Companies Act and to find out what is the nature of proceedings and also ingredients thereof. Section 542 requires showing that the business of company has been carried on with intent to defraud creditors of the company or any other persons or for any fraudulent purpose. There is no such plea by the official liquidator in his first application before this court. It is only contended that the ex-directors failed and neglected in performing the duties and put the company into heavy loss. Even in the subsequent points of claim it is only generally contended that the directors manipulated accounts, falsified the same for their own gain. However, again no details in this respect are given. In this respect it will be beneficial to make reference to Official Liquidator Vs. Ram Swarup, , where it has been held that the object of Section 542(1) is to make the discharge of debts and other liabilities of the company consequent on the fraudulent conduct of the business of the company the personal liability of those who have knowingly participated in such fraudulent activity. The expression "personal liability" is used to contradistinguish it from the liability of the company. While Section 542(1) provides for the declaration of the personal liability of the persons concerned with fraudulent conduct of business. Section 542(2) provides for giving of appropriate directions for the purpose of giving effect to that declaration. Therefore, the inquiry which has to be made u/s 542 with regard to the purpose with which the business of the company had been carried on by the persons who were knowingly parties to the same. The facts in the Allahabad case show that the directors of the company had unjustifiably withdrawn huge amount out of the capital of the company and continued to carry on the business of the company even thereafter knowing fully well that the company is running at a loss and was unable to pay its dues to the Government or to the workmen. It was found that the losses did not pertain to the period in which the receiver was appointed in the year 1969 but the receiver had to be appointed only because the company was running at a loss and was unable to pay off its dues. Thus the creditors were not paid while the director had the use of the company's money and that too free of interest. Thus the money was found to have been withdrawn by the directors so as to deprive the creditors from being paid. From the facts and circumstances of the case an inference could legitimately be drawn that the directors were aware that the company was running into heavy losses and was likely to be liquidated and, therefore, withdrew their capital from the company.

And to camouflage their action it was shown that the withdrawals being made by the directors were in the shape of interest free loan against the security of their shares. Therefore, the provisions of Section 542 of the Act were held it to be applicable against the ex-directors of the company. The Allahabad High Court has further observed that the director is an agent of the company and owes twin duties to the company, first, the duty of loyalty and second the duty of care. Breach of these duties amounts to breach of trust and misfeasance. In other words misfeasance arises when there is breach of trust qua the company resulting in loss to the said company. Applying these tests to the facts of the case before the Allahabad High Court said that the ex-directors of the company having withdrawn the major part of the share capital of the company even while the company was functioning and thus having caused loss to the company, have committed breach of trust and consequently can be held to be liable for misfeasance. Further, where the conduct of the directors is clearly in breach of their duty of loyalty to the company, the directors are liable to compensate the company for the loss caused by their conduct to the company. Moreover in view of the admission made in the affidavit filed by the ex-directors in the High Court and also from the admissions made in the statement of affairs filed by the ex-directors before the official liquidator, the onus on the official liquidator to prove misfeasance and breach of trust on the part of the ex-directors was held to have been adequately discharged. The directors of a company occupy a fiduciary position. Therefore, this section provides relief by a summary procedure to assess their liability. The court in the course of winding up a company assesses and compels a delinquent director or officer to make payment in respect of the acts of misfeasance or malfeasance breach of trust or wrongful retention or other misconduct. The proceedings are civil in nature and the question of establishing mens rea by the official liquidator does not arise. Thus the Allahabad High Court has held that the provisions of Sections 542 and 543 of the Act would be attracted against the ex-directors.

8 Hence, this matter is basically u/s 543 of the Companies Act. The said section reads:

543. Power of court to assess damages against delinquent directors, etc.-(1) If in the course of winding up of 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.

9. In *The Official Liquidator, High Court of A.P., Hyderabad Vs. T.J. Swamy and others*, , the High Court has found that individual and specific assertions are a must in such cases and has observed as under (page 701):

I have gone through the averments made in the petition vis-a-vis, the evidence adduced in support of the petition. It is not in dispute that Section 543 is introduced in the interest of the company and to protect from the misapplications and misfeasance or breach of trust on the part of the directors. The power is given to the court to recover or restore the money or property or any part thereof respectively, the official liquidator in the event it finds that the officers of the company acted to the detriment of the interest of the company. It is to be noted that while making an application under this provisions, it is necessary that the allegations or the charges against the officer must be very specific and it should not be vague and general in nature. It should contain the narration of specific acts or commission or omissions on the part of the director or officer of the company. In the absence of such specific pleadings, the application becomes susceptible for successful attack by the respondents. Even to examine the conduct of the particular officer or director to make him personally liable for misfeasance and misconduct, there should be specific evidence and pleadings as regards the conduct of the officer as held in *Security and Finance Pvt. Ltd. v. B.K. Bedi* [1991] 71 Comp Cas 101 (DeL).

It has also been further held by the courts that even if the charge of misfeasance has been established, it should result in loss to the company and then only the court could compel them to compensate. Therefore any misfeasance or misconduct without resulting in loss to the company cannot be successfully pressed into service u/s 543 of the Act.

After scanning through the evidence adduced on behalf of the parties, I find that the petitioner has not been able to establish that the respondents either misapplied or retained money or property of the company or committed an act of misfeasance or breach of trust in relation to the company. The allegations in the petition and the evidence adduced by the petitioner are most general in nature. No specific or a particular allegation has been made to each and every respondent so as to make him responsible for repaying or restoring the money or property of the company. Though the directors and the managing director fall

within the category of the officers as defined u/s 2(30) of the Act, yet unless the individual responsibility is identified and established it would be difficult for this court to grant appropriate reliefs to the petitioner. The only documents which are filed are the audit reports and the balance-sheet from which it cannot be established that there was a misfeasance on the part of the respondents. It is also accepted by the PW 1 that the company prior to winding up have filed certain suits and after the winding up order the official liquidator also filed the suits and some of them have been decreed and the process is on for execution of decrees. With regard to the alleged excess expenditure incurred by the company on tours and travels, etc., no evidence has been adduced to sustain the allegation. The section is very specific that it aims at individual and personal misconducts and, therefore, it is essential to establish the individual acts of omissions and commissions. Even assuming that the acts of omissions when done jointly and severally by all the respondents, yet there should be evidence before this court to establish such an allegation. This is also lacking in the instant case.

10 In *Sajida Book Shop Vs. Kaumudi Exporters (P) Ltd. and Others*, , again necessity of specific assertions against individual has been emphasised and it is observed as under (page 545):

It is after a year he has again approached with this miscellaneous company application u/s 543 which enables any creditor or contributory, apart from the official liquidator or liquidator, to apply to the court, if it appears that any person who has taken part in the promotion or formation of the company or any past or present director, manager or officer,

(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.

While trying such an application the court can examine into the conduct of the person or director against whom the allegation of commission or omission which resulted in misapplication, or misfeasance has been made. It is invoking that provision the applicant has approached this court with this M. C. A. The allegation in respect of the respondents Nos. 2 to 8 who are the former managing director or directors or officers of the company is that they retained or misapplied or misappropriated the fund of the company and they have become liable or accountable to refund the said sum of Rs. 5,54,910 to the company and their action in the matter of retention or misapplication or misappropriation amounts to misfeasance or breach of trust in relation to the company.

A reading of the miscellaneous company application shows that there is no specific allegation against any of the former managing director or directors as to the role they have played in the alleged misapplication or misappropriation and consequent misfeasance. No details have been supplied in the application so that

the respondents can answer to such allegation. Even in evidence, the applicant has no definite case about the role of any, or each of the respondents. A bald allegation regarding purchase of land by another company of which respondents Nos. 2 to 8 are stated to be directors alone, is made.

11. In *M/s. Faridabad Rubber Soles Private Limited (in Liqn) Vs. S.L. Chopra and another*, allegation of mere inaction on part of directors to act has been held to be insufficient to attract provisions of Sections 542 and 543 of the Companies Act. The observations can be reproduced for the benefit of consideration (page 977):

7. 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 ps 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 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. Kaithal (in liquidation) v. Lachman Das* [1954] 56 Pun LR 486 where the learned judge relying on the observations of *Jessel, M. R. In re : Forest of Dean Coal Mining Company* [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 to 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.

12 The Karnataka High Court has in *Chamundi Chemicals and Fertilizers Ltd. v.*

M.C. Cherian [1993] 77 Comp Cas 1 has held as under (headnote):

Mere negligence or neglect of duty will not by itself create liability unless there was gross negligence amounting to misfeasance or breach of duty resulting in loss to the company. It is well laid principle of law that in order to make the directors personally liable u/s 543 for misfeasance, it is necessary to show that the directors have dishonestly acted or abstained from acting in conflict with their plain duty, and that by reason of the act of the directors the company has incurred loss.

13 In *Official Liquidator v. G. Shanmugham* [1979] 40 Comp Cas 903 (Mad), it is stated that there should be a prima facie proof of negligence bordering on misfeasance and breach of trust which alone can be the basis for the punitive rule contained in Section 543. Unless there is nexus between the accountability which is claimed by the official liquidator and any personal act on part of one or other of the delinquent directors, it cannot be said that they are squarely responsible within the meaning of Section 543(1) of the Companies Act.

14. The application of mind by hon'ble apex court as revealed in *Official Liquidator, Supreme Bank Ltd. Vs. P.A. Tendolkar (Dead) by Lrs. and Others*, is also important. In paragraphs 41 and 42, the hon'ble apex court has considered the articles of association of the company and thereafter in subsequent paragraph has considered the position of the managing director of the company as emerging on record and thereafter a finding of his negligence has been reached. The findings in paragraph 43 may be stated (pages 402, 400 and 404):

43. Upon the facts examined by the learned company judge very fully and less fully by the Division Bench and the findings recorded thereon, it is clear to us that although the managing director was conducting the day-to-day affairs of the company and must, therefore, be held responsible for a greater share of losses incurred due to misappropriations, dishonesty, and misuse of managerial powers, yet, his co-directors could not possibly be ignorant of the nature of such dealings and activities of the employees and the managing director simply because they had executed a power of attorney in favour of the managing director. The company judge, relying upon observations in *Overend and Gurney Co. v. Gibb* [1872] L. R. 5 HL 480 had held that:

The directors were cognizant of circumstances of such a character, so plain and so manifest, that no men with any ordinary degree of prudence, acting on their own behalf, would have conducted themselves in the manner the directors of this company have done.

The proved conduct of the founder directors was such that an inference of their complicity in concealing the true state of affairs from depositors, presumably because they were themselves benefiting from it, could not be avoided.

40. 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.

46. The learned company judge as well as the Division Bench had referred to the difficulties encountered in determining the actual total loss to the company because of want of any reliable statement of account. This state of the records of the bank was itself evidence of breach of their duties by the managing director and the board of directors to see that the business of the bank was honestly and efficiently conducted.

15 In *The Official Liquidator Vs. Raghawa Desikachar and Others*, the hon'ble apex court has held in para. 7 "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 company arising out of such acts or omissions. The burden of proving misfeasance or non-feasance rests on the official liquidator."

16 Here it is not the case of the official liquidator that the statement of accounts were not made available to him. On the contrary it appears that the earlier chartered accountant has completed the audit up to period January 1, 1987, while the supplementary investigation report for further period up to August 29, 1989, is prepared by the subsequent chartered accountant on October 18, 1989. Three directors alone are respondents before this court while both the reports implicate other directors also. Moreover, the respondents or their position and relation qua each other or vis-a-vis the company has not been either pleaded or pointed out in these proceedings. There are no individual/personal allegations on lines as stipulated above against any of the respondents.

17 In his evidence the subsequent chartered accountant has merely reproduced the points of claim. In his cross-examination he has admitted that his affidavit or report is incorrect to the extent of Rs. 42,867.65 (travelling allowance). He has agreed that whenever a party approaches a court of law expenses become necessary and bills may not be received in all cases. He has expressed his inability to say whether amount of Rs. 13,230 could have been spent towards

legal proceedings, i.e., a writ petition filed in the 1987. He further accepted that he did not make any personal investigation and did not visit Avion Pharmaceuticals or did not see the papers of Central Bank of India. He has stated that the explanation given by the ex-directors was not supported by documents and hence he has not considered it. He further stated that as the directors admitted the list of sundry debtors, he did not make any inquiry with the said sundry debtors. He accepted that these were letters and correspondence of general nature for recovery. He stated that though he has seen the memorandum and articles of association, he does not know whether there was provision for monthly remuneration of Rs. 1,000 to the directors. He further stated that he made no inquiry with the directors in this respect. He further accepted that his report is based upon the report earlier submitted by the earlier chartered accountant. He stated that recovery of Rs. 79,914.48 has been mentioned by him on the basis of the said report. He further stated that as his assignment was for a limited period, i.e., from January 1, 1987, till August 29, 1989, he did not verify from the account books for earlier years. He further accepted that amount of Rs. 79,723 represents the cost of medicine of which expiry date was over and hence could not be sold in market.

18. The next witness of the official liquidator is only an employee with the earlier chartered accountant who identified the report submitted by the said chartered accountant Shri Salve by identifying the signature of Shri Salve. He stated that he was supervising the said investigation work and the report submitted is on the basis of record. He has further stated in cross-examination that he was not qualified as a chartered accountant. He further stated that he did not do audit work or investigation work personally. The preparation of observation and query note at the time of inspection and its availability is admitted by him. He has also disclosed the successor of the earlier chartered accountant with whom those records are available.

19. R. B. Sangare on behalf of the respondent stated that the accounts are properly maintained and all vouchers are with the official liquidator. He has further stated that the amount on tour and travel of directors has been rightly accounted for and the amount of Rs. 13,230 was spent on legal proceedings. He stated that stocks were lying with Avion Pharmaceuticals at Thane and the same were of raw material and packing material hypothecated with Central Bank of India. He has stated that because of the financial condition the loan of Central Bank of India could not be repaid and the goods could not be released. He has stated that the raw material was expired drugs which could not be sold. Similarly, packing material with the name of company on it also could not be sold. He has further stated that the amount was due from sundry debtors like distributors agents and stockists and that as the company could not carry out its production due to financial crisis, the recovery could not be effected as the distributors, stockists and agents contended that the goods with them had already expired. He accepted that amount of Rs. 2,07,300 only has been received by the directors for their survival and it is reflected in the accounts. He further stated that

amount of Rs. 3,500 has been paid to the landlady towards telephone charges as the company was using that phone. He further stated that amount of Rs. 74,914.48 received from different persons is accounted in the books of the company. He has further stated that the company returned to stockists, distributaries an amount of Rs. 79,732.26 towards goods returned to the company by them and it is correctly reflected in the accounts of the company. In his cross-examination he has accepted that expenses of Rs. 69,691.66 towards tour and travel are not supported by bills/vouchers and statements. He has denied that there is no voucher/bill of legal expenses of Rs. 13,230. He has further stated that remuneration was received by each director in spite of the resolution dated May 6, 1992, without passing any other resolution to the contrary but by general consensus of all directors. He has expressed inability to point out as to why there is no correspondence on record in respect of sales returns on expiry.

20. The brief survey of the evidence above reveals that neither the official liquidator has ascribed any malice or ill motive to the respondents nor is any such allegation made or suggestion given in the respondent's cross examination (of R.B. Sangare). It is not even suggested to him that he or any other respondent failed to discharge their duties towards the company. The report of the subsequent chartered accountant proceeds further by treating the earlier report as the base. The earlier report has been exhibited in view of order dated April 21, 2005, but at the same time the question regarding the truth of its contents was kept open. The cross-examination above of employee Shri Dastur of the earlier chartered accountant reveals that he has no personal knowledge about the contents and he has not prepared the said report. It further appears that the notes and queries raised by the earlier chartered accountant could have been produced before this court by the official liquidator. However, no effort has been made by the official liquidator in the direction. It is thus more than apparent that the truth of the contents of the said report has not been established and, hence, the said report cannot be looked into,

21. There are two reports of chartered accountants on record. Though, the earlier report of Shri Salve cannot be considered to the prejudice of the present respondents, still contradictions between the two can be gone into to find out the correctness of the claim as made before this court. It is important at this juncture to note that the order of winding up has been passed on August 29, 1989, when the official liquidator came to be appointed as its liquidator. Section 543(2) prescribes limitation of 5 years from the order of winding up or from the order of appointment of liquidator or from the date of misapplication, retainer, misfeasance or breach of trust whichever happens last. The company came to be liquidated on August 29, 1989, and as such, there is no transaction thereafter. With the result, the period of 5 years expired by the end of August, 1994. The present application has been filed on August 17, 1994, i.e., within five years. The improvements in the matter being made by the second report dated October 18, 1999, in the earlier report dated April 30, 1994, therefore assume importance.

As already stated above, the earlier report contained 11 heads and the amount due from directors was shown at Rs. 10,51,714.22 only. In the latter report there are substantial modifications and it contains 8 heads of recovery while the amount due has been reduced to Rs. 6,68,768.97 only. Some of the earlier heads are totally deleted while new heads have been added. In the earlier report, under the first head recovery of travelling allowance has been shown as Rs. 42,867.65 while in the latter it has been erroneously shown as Rs. 69,691.66 but has been later on corrected by adjusting Rs. 42,867.65, i.e., the earlier amount which was found to have been paid and the correct recovery in this respect is Rs. 26,823.01 only. Though the subsequent chartered accountant has accepted this error in his cross-examination, the official liquidator has repeated it in written notes of argument. In fact, the subsequent chartered accountant has deleted this entire claim and has further added a new claim on the basis of examination of accounts for a subsequent period. Thus, this claim for Rs. 26,823.01 was not forming part of the earlier claim lodged within five years and a new claim for the subsequent period has been made after the said expiry. In the earlier report, under the second head recovery of Rs. 6,233.95 only has been worked out towards advance to medical representative. However it is entirely deleted in the subsequent report. In the old report, under the third head, recovery of Rs. 31,908.93 is shown on account of other advances. These are totally deleted in the subsequent report and a new figure of Rs. 13,230 only for the subsequent period of 1988 and 1989 is submitted. Again, this substitution of a new claim is beyond the period of five years. In the earlier report, under the fourth head recovery of Rs. 5,248 only has been shown on account of sale price of vehicle. In the subsequent report this recovery is found to be factually incorrect and has been deleted. In the earlier report under the fifth head difference in value of furniture and fixtures of Rs. 4,000 was sought to be recovered but it has been totally deleted in the subsequent report. In the earlier report, under the sixth head, recovery of Rs. 30,000 only was worked out on account of land at MIDC and this recovery also is found to be erroneous and deleted in the subsequent report. In the earlier report, under the seventh head, recovery of Rs. 4,25,591.03 only was sought to be effected for value of stock. In the subsequent report, it is found that this amount is the amount of loans outstanding from the United Western Bank Ltd., Nagpur, and not the value of stock. It is mentioned that there were certain stocks with M/s. Avion Pharmaceuticals, Thane, which were not reflected in the balance-sheet of 1989 and their value has been worked out at Rs. 93,425.18 and it has been substituted for the recovery under the seventh head. Thus only the charge has been replaced by a totally new charge/head of recovery. In the earlier report, recovery of Rs. 15,446.98 was shown on account of bank balance and in the new report, it has been found that there is FDR of Rs. 15,000 and balance of Rs. 446.98 in Central Bank of India. Hence this recovery has been deleted. The recovery of Rs. 2,08,153.20 has been shown from sundry debtors under head 9 in the earlier report. In the new report, the subsequent chartered accountant has considered the correspondence and also explanation given by the directors in which they have stated that action for

recovery could not be initiated because of financial problems. It is observed that there were major recoveries in 1987 and the outstanding recovery was only Rs. 1,26,975.39 only. It has not been pointed out that it was possible for the directors to initiate legal proceedings and there are no motives otherwise attributed to them. The recovery under head 10 of Rs. 2,07,300 has been maintained on the ground that the directors could not have taken this amount as their remuneration. The question is already considered above and the official liquidator has not pointed out that the memorandum or articles did not permit remuneration to the directors. It is also the case of the respondents that all the directors continued to draw their remuneration as per these provisions and tacitly, the resolution was either not implemented or stood modified. Again, the official liquidator has failed to demonstrate how this constitutes malfeasance or misfeasance. The recovery under head 11 as proposed in the earlier report for Rs. 74,914.48 has been maintained even in the new report. However it is on account of sales return, expiry and expiry as revealed on December 31, 1988, August 29, 1989, of paragraph 13 of this new report. In the earlier report of Shri Salve this recovery was shown as per its paragraph 5.1 and Schedule B and it was on account of cash vouchers not entered in the cashbook. Thus a totally new head and recovery has been pointed out by the subsequent chartered accountant.

22. From the discussion above, it is apparent that the subsequent chartered accountant Shri Pimparkhede has partially maintained recoveries under heads 9 and 10 of the earlier report. Head 9 has been partially modified. However, while modifying this recovery the earlier report has been used as stated by the subsequent chartered accountant without verification of this authenticity. When the truth of the earlier report itself is not proved, the report of the subsequent chartered accountant treating it as the base for the subsequent report cannot be accepted. The recovery from sundry debtors as observed by the subsequent chartered accountant therefore cannot be held against the respondents. The only charge/head of recovery as included in the earlier report and maintained even in the subsequent report is therefore the remuneration of directors. For the reasons already stated above, in the facts and circumstances of the case, it has not been substantiated and cannot form part of these proceedings. Thus, I find that the official liquidator has failed to make out any case for recovery u/s 543 of the Companies Act.

23. The issue of limitation in view of Section 543(2) of the Companies Act needs to be looked into in the wake of the subsequent report of the chartered accountant. In this respect reference can be made to a Division Bench judgment of this court in *The Official Liquidator, High Court, Bombay and Liquidator of Jai Hind Estate and Housing Co. Ltd. Vs. Taru Jethmal Lalvani and others*, Paragraphs 6 and 7 explain the situation as under (page 76):

6. Under Order 1, Rule 10 of the CPC the court has the power to strike out or add parties to the suit. However, where the suit is brought against a person who is found to have died before institution of the suit (he being the only defendant),

the plaint cannot be amended by bringing his legal representatives on record though the suit may have been filed in ignorance of his death. This is because a suit against a dead man is a nullity. Of course if a suit is against several defendants and only one of them is found to have died before its institution, the entire suit will not fail and can proceed against the other defendants. The legal representatives of the deceased defendants can be joined, provided a fresh suit could have been filed on that date. Therefore, on analogous principles, if a misfeasance summons is instituted against several respondents and some of them are dead, the heirs of the dead respondents can be joined as party respondents by amendment, provided that a fresh misfeasance summons could have been taken out against the heirs on the date on which they are sought to be joined. In the present case, on the date of Company Application No. 75 of 1988 no misfeasance summons could have been taken out against the heirs of respondents Nos. 1 and 16, because the time for taking out such misfeasance summons prescribed u/s 543(2) of the Companies Act had expired long prior to the taking out of Company Application No. 75 of 1988.

7. It was submitted by Mr. Parikh, learned Counsel for the appellant that the principles of Order 1, Rule 10 and of Section 21 of the Limitation Act which provide that when a new plaintiff or defendant is substituted or added, a suit as regards him shall be deemed to have been instituted when he is so made a party, apply only to a suit. We do not see why misfeasance summons should not be governed by the same principles. He further submits that even though the misfeasance summons is taken out against dead respondents, their heirs can be subsequently brought on record even beyond the period prescribed u/s 543(2), because according to him, u/s 543(2) only an application is required to be made within the prescribed period. Once an application is made, somebody can be subsequently joined as a party to it. Such an interpretation cannot be accepted. Section 543(2), when it refers to an application, must necessarily refer to an application against a specified person or persons. It cannot be an application in the abstract. Therefore, when the heir of a respondent who was non-existent at the time when the original misfeasance summons was taken out is brought on record, it is equivalent to taking out a fresh misfeasance summons against the heir. There is no question here of the amendment relating back to the date of the original misfeasance summons against some other parties. Therefore, this contention must be rejected. In view of this position, we do not see how the present Company Application No. 75 of 1988 can be granted.

24. It is more than apparent that proceedings u/s 542 or 543 of the Companies Act are not a fresh investigation. A period of five years is given to the official liquidator to complete his investigation and to file these proceedings for recovery. Here, there was no effort even to amend the original proceedings in the light of material discovered in report of the subsequent chartered accountant. It is more than obvious that recovery discovered after expiry of the said period of five years cannot be considered in these proceedings. Even on this count, I find that the proceedings are not tenable in relation to substituted/new charges.

I, therefore, find that no case, either u/s 542 or u/s 543 of the Companies Act is made out against the respondents. The company application is accordingly dismissed with no order as to costs.