(1941) 05 MAD CK 0007

In the Madras High Court

Rao Sahib V. Subbayya and Others APPELLANT

Vs

C.T. Machayya and Another RESPONDENT

Date of Decision : 01-05-1941

Acts Referred:

Citation : AIR 1942 Mad 365 : (1942) 55 LW 165 : (1942) 1 MLJ 207

Hon'ble Judges : Venkataramana Rao, J

Bench : Division Bench

Judgement

Venkataramana Rao, J.—These four appeals arise out of an order passed by the learned District Judge of Bellary u/s 235 of the Indian

Companies Act in the liquidation of Hospet Sugar Mills Limited. The directors past and present of the said Company were sought to be made

liable in respect of various acts of misfeasance committed by them in consequence whereof the Company suffered loss. During the course of the

hearing of the petition the Official Liquidator confined himself to the claim against them for Rs. 25,000 which was paid as and for remuneration of

Messrs. Johnson & Co., the Managing Agents of the said Company, and the Income Tax on it. In respect of the said sum R. Narasinga Rao, the

appellant in C.M.A. Nos. 576 and 577 of 1938 was made liable for Rs. 25,000, Rao Sahib V. Subbayya the appellant in C.M.A. No. 501 of

1938, for Rs. 5,000 and Rao Sahib V. Dharmalingam Pillai, for Rs. 10,000. Before dealing with the question of liability, it will be very necessary to

know the history of this Company, its formation and its subsequent working until the date of its liquidation. This Company as appears from the

evidence was the creation of one C. M. Mehta, who is a resident of Bombay and claims to be a ''share broker and whose antecedents are not at all known to anybody. He conceived the idea of starting this sugar mills with the aid of his relations, his own wife, Mrs. Mehta, his sister-in-law and

her husband, R. Narasinga Rao. This Narasinga Rao was originally a copyist in the Anantapur District Court, later became a Local Fund

contractor and absolutely had no connection with any sugar business. He was associated in the formation of the said Company and also in its

subsequent working until the date he severed connection with the Company. The constitution of this Company from time to time discloses a deep

scheme of fraud laid out by Mehta. On the 27th April, 1933, a consent statement was submitted to the Sub-Registrar of Assurances which was

signed by Mehta, his wife, R. Narasinga Rao and R. C. Dalai, the nephew of Mehta, Within two or three days after that submission of the

statement, there was a change in the directorate, Mehta, his wife and R. C. Dalai having resigned and in their places Rao Sahib V. Subbayya, Rao

Sahib V. Dharmalingam Pillai, Mr. McGavin and Mr. C. J. Court having been appointed. Rao Sahib V. Subbayya and Rao Sahib V.

Dharmalingam Pillai were recruited on the specific understanding that they need not pay for their qualification shares. As observed by the learned

District Judge both of them had titles and Rao Sahib ''V. Dharmalingam Pillai was besides an M.L.C. and an Honorary Presidency Magistrate. Mr.

McGavin and Mr. C. J. Court were recruited for the sake of European names so that the public may be taken in. Mr. McGavin described in the

prospectus as a motor engineer was a mechanic in a toddy contractor''s lorry living in a small house in Bellary on a rent of Rs. 3 per month. The

antecedents of Mr. C. J. Court are not known and he died before the proceedings commenced, though his status seems to have been no better

than that of McGavin. One Mr. Hackett was appointed secretary of this Company. He had absolutely no experience of business, much less of

sugar business. The object of the Company was to attract a large capital and this Company succeeded in getting nearly two lakhs of rupees. Mehta

also at the same time brought into existence three other companies and. their constitution is very curious. Messrs. Johnson & Co., were appointed

as the Managing Agents of the Company under a contract, dated 27th March, 1933, (Ex. Y) in and by which they were allowed Rs. 1,000 per

month for the management and,, 10 per cent. of the profits. The partners of this Company are Narasinga Rao and his wife, the mother of Mehta and an infant son of Mehta, 18 months old. The partners are therefore Mehta and his relations and except Narasinga Rao the others are ladies and

an infant who can hardly be expected to undertake the management of a sugar concern. Another Company which was brought into existence was

the Eastern Underwriters Syndicate and its partners are the nephews of Mehta who disclaim all responsibility thereon on the ground that their

signatures were forged by Mehta. There was another Company called the Thakore & Co., whose constitution is a mystery and to whom a sum of

Rs. 59,000 was advanced for the purpose of erecting a factory. As the learned Judge points out in paragraph 12 of his order

these facts show that the control of this Company was directly or indirectly in the hands of Mehta and his various manifestations as Messrs.

Johnson & Co., (by his wife, mother and his brother-in-law until 15th July, 1934), as the Eastern Underwriters Syndicate and as Thakore. & Co.

and that the directors of the Company were his relations or other persons completely under his influence with the exception of V. Subbayya, V.

Dhannalingam, and later of Sirdar Kanjilala, while V. Subbayya and V. Dharmalingam were recruited under conditions suggesting that all that was

desired was to make use of their titles for the attraction of investors without anticipating that they would interfere in the working of the Company as

they lived in Madras.

As already stated, the Sugar Mills Company was incorporated on 27th April, 1933 and the prospectus was fesued on 3rd May, 1933 and it was

anticipated that the factory for manufacturing sugar would be ready to start work by December, 1934. Although a sum of Rs. 57,000 is shown as

spent on factory and equipment, no factory was ever erected except a few small buildings. The Company was voluntarily wound up by a resolution

of the directors, dated 13th December, 1935, and in January, 1936, Bhima Rao, who was acting as the legal adviser of the Company was

appointed voluntary liquidator, and an original petition (O.P. No. 21 of 1936) for the winding up of the Company subject to the supervision of the

Court was presented to the High Court when Mr. C. T. Machayya was appointed additional liquidator. It is admitted that no proper accounts

were ever kept. For the purpose of audit the accounts were cooked up in March or April, 1934 and the report of Mr. Batliboi (Ex. N) revealed a deplorable state of affairs. A reply to this report was given by Messrs. Johnson ..& Co., and the meeting, dated 15th July, 1934, presided over by

Dharmalingam Pillai accepted the explanation given and condemned Mr. Batliboi''s conduct. As the learned Judge remarks, it is difficult to imagine

that anybody could have been satisfied with the explanation. Mr. Batliboi pointed out among other things that the entry in the cash book of Rs.

50,000 as received was false, and there was no satisfactory evidence to show that a sum of Rs. 59,000 was paid to Messrs. Thakore & Co. He

has also said that he had considerable difficulty in getting the books, that many of the books were stated to be missing and that the books

produced before him as rough and fair cash books appeared to him to have been fabricated. The explanation that was given was only an attack

against Mr. Batliboi and the answers given to various charges would not appear to any prudent man to be at all convincing. There was a

subsequent audit by Messrs. Sharp & Co., whose report was not satisfactory and things were allowed to be drifted on in the same state as it was

before, the result of which was that nearly all the money that was received by the Company disappeared and when the liquidators took charge,

there was a cash balance of Rs. 2-1-6. It may be stated that V. Subbayya tendered his resignation on 18th August, 1933, that is, even before the

Company had been formed. Dharmalingam Pillai resigned on 24th June, 1935 and Narasinga Rao ceased to have connection with the Company in

July, 1934.

2. In the light of the above facts the question is how far the appellants in the various appeals are responsible for the payment of the remuneration of

Rs. 25,000 to Messrs. Johnson & Co. We will first consider the case of Rao Sahib V. Subbayya, the appellant in C.M.A. No. 501 of 1938. It is

no doubt true that he signed the prospectus, dated 3rd May, 1933, without in the least caring to know what the antecedents of the other directors

were or knowing about the way in which the Company was going to be worked and who the partners of Messrs. Johnson & Co., were. But on

18th August, 1933, he tendered his resignation, that is, nearly 12 days before the declaration u/s 103 of the Companies Act was sent to the

Registrar of the Joint Stock Companies and before the Company commenced business. It cannot be said therefore that he was guilty of any misfeasance by reason of which any pecuniary loss was sustained by the Company and it is in evidence that whatever payments were made to

Messrs. Johnson & Co., it was after July, 1934, i.e., nearly a year after the date of his resignation. We are therefore of the opinion that the finding

of the learned Judge in so far as he holds him responsible should be set aside and the appeal allowed. But having regard to his conduct in siigning

the prospectus, we deprive him of his costs throughout.

3. The case of Dharmalingam Pillai stands on a different footing. Both Subbayya and Dharmalingam Pillai agreed to be directors on the promise

held out to them by Mehta that they need not pay for their shares. In the case of Subbayya the shares in favour of the wife of Mehta were

transferred while in the case of Dharmalingam Pillai, though he was declared to be the holder of shares, he did not pay anything for them.

Becoming a director by accepting a gift of shares without paying for them is a misfeasance. No doubt he cannot be rendered liable for the loss in

respect of this act of misfeasance because no charge has been framed against him. But the fact remains that he began his connection with the

Company with an act of misfeasance. This fact and the prospect of earning director''s fees were the sole motive which induced him to become a

director. He could not have known Mehta earlier. Before he signed the prospectus it was his duty to have acquainted himself with the antecendents

of Mehta and also of the other directors and furthermore, who the partners of Messrs. Johnson & Co., were. He signed the prospectus with the

recital that an agreement had been or would be entered into with Messrs. Johnson & Co. A slight enquiry would have revealed that the directors of

Messrs. Johnson & Co., were ladies and an infant and Narasinga Rao who is a relation of Mehta and that that Company would practically be

under the control of Mehta. A reference to the agreement of Messrs. Johnson & Co., would have revealed that a sum of Rs. 1,000 was to be paid

to them from the date of the registration of the Company exclusive of all rents of the Company, salaries, emoluments and wages paid to the clerks,

servants and employees of the said Company which are all to be paid out of the Sugar Mills. Further they were to be paid 10 percent. of the

profits of the Company. It was his duty to ascertain whether it would be prudent to entrust the management of the Sugar Mills Company to

Messrs. Johnson & Co., on such a'' very heavy remuneration. No prudent man would consent to the management of the Sugar Mills to a firm

constituted as Messrs. Johnson & Co., were. He must have also known who the Eastern Underwriters Syndicate were, which again was the

creation of Mehta. There may be cases where a director can confide in a co-director or directors whose antecedents were well-known and whose

capacity for business management was well-tried. But there was absolutely no reasonable ground for Dharmalingam Pillai to confide in Mehta

whom he could have only met for the first time when a request was made to become a director of the Company and it does not appear from the

evidence that either at that time or at any time subsequently Dharmalingam Pillai ever cared to find out what the antecedents of Mehta were and

whether it was prudent on his part to continue to confide in him. Whatever may be the justification until 15th July, 1934, we think that after that

date his passivity is inexcusable. The audit report of Batliboi & Co., which exposed the frauds of the Company should have put Dharmalingam

Pillai on enquiry as to the antecedents of Mehta and particularly as to the propriety of Messrs. Johnson & Co., continuing to be the Managing

Agents of the Sugar Mills or of payment of any remuneration to them. But it is rather surprising that he should have accepted the explanation of

Johnson & Co., which condemned Batliboi''s report on grounds which no man exercising some reasonable care would ever accept. He presided at

the meeting and was a party to the resolution which condemned Batliboi''s report. He signed the balance-sheet which sanctioned a, remuneration

of Rs. 13,000 to Messrs. Johnson & Co. It was between July and November, 1934, that a sum of about Rs. 6,000 was paid to Johnson & Co.,

and this could not have happened if Dharmalingam Pillai had taken steps to satisfy himself whether the allegations made in Batliboi''s report were

correct and whether it would be wise or safe to continue the management by Messrs. Johnson & Co., and whether they were entitled to be paid

the remuneration which was stipulated, for according to the agreement having regard to the way in which the Company was managed and

particularly in view of the serious allegations made by Batliboi that all the account books put before him appeared to be fabricated. We are

therefore clearly of the opinion that Dharmalingam Pillai was guilty of gross and wilful negligence and clearly guilty of misfeasance within the meaning of Section 235 of the Act. Mr. V. C. Gopalaratnam cited to us a number of cases to show that Section 235 would not apply to a case of

mere non-feasance. Section 235 does not prima facie exclude non-feasance. In our opinion the section would apply to every act whether of

commission or omission which is a breach of duty to the Company in consequence whereof loss to the Company results. Mr. Gopalaratnam laid

considerable emphasis on In re Etic, Limited (1928) 1 Ch. B. 861 for the position that the section would not apply to a case of non-feasance but

that decision does not support him. Maugham, J., after reviewing all authorities sums up the position thus:

It (Section 215) is limited to eases where there has been something in the nature of a breach of duty by* an officer of the Company as such which

has caused pecuniary loss to the Company.

This would take in non-feasance also. In the earlier portion of the judgment he refers to Ex parte Petty (1882) 21 Ch.D. 492 and to the view of Sir

George Jessel, M.E., viz., that Section 215 would apply to every wrongful act by the director, manager, liquidator or other officer of the Company

either of the nature of misfeasance or of the nature of a breach of trust in a wide sense including no doubt a breach of trust by negligence or

something of that kind. No doubt language is used in some of the cases that mere negligence is not enough but there should be gross negligence but

it is unnecessary to deal with those cases because as we have already stated on the facts of this case it is clear that Dharmalingam Pillai was guilty

of gross negligence which would be misfeasance within the section. He not only did not exercise that amount of reasonable care which was

expected of him as a director in ascertaining the true state of affairs of the Company but also wilfully shut his eyes to it until a very late stage. The

only question is, what is the amount for which he should be rendered liable? He is only one of the directors and it cannot be said that he was guilty

of any fraud or corruption. We therefore make him liable for a sum of Rs. 5,000. In view of our findings it is not possible to give him relief u/s 281

of the Act, but in assessing compensation we did take the matter also into consideration.

4. In regard to the appeals filed by Narasinga Rao, Mr. Bhujanga Rao was not able to convince us that the findings of the learned Judge are

wrong. Narasinga Rao was associating in the fraud of Mehta from the very beginning. He is closely related to Mehta having married his wife''s

sister. He assisted Mehta in the formation of the Company. He was one of the partners of Johnson. & Co., and in fact the only male partner of that

Company. He signed the prospectus with the full knowledge of the then state of affairs of the Company. It was he that signed the declaration to

enable the Company to get a certificate u/s 103 of the Indian Companies Act. He was a party to the false statement made therein that every

director of the Company has paid to the Company on each of the shares contracted to be taken by him and it has been proved in this case that the

shares in the name of ""Dharmalingam Pillai were not paid for by him. No doubt he says that he was completely a tool in the hands of his wife or

Mehta but it is not possible to rely on his statement. There can be no doubt that he was throughout associated with Mehta in all the frauds

committed by the latter, in the formation of various companies by which the funds of the Company were diverted. He signed the contract with

Messrs. Johnson & Co., on behalf of Sugar Mills. Until he came away from the Company, he was acquainted with all its activities. After he ceased

his connection in 1934, it was his duty to have exposed all the activities of Messrs. Johnson & Co. If he had done so, the persons interested in the

Company would have taken proper steps in regard to the affairs of the Company, and the subsequent payment of remuneration to Messrs.

Johnson & Co., would have been averted. He did not do so and he is certainly liable for all the loss which the Company has sustained. He was

however not a party to the payment of remuneration to Messrs. Johnson & Co., and in fact no advance was paid to them till he severed his

connection with the Company. Besides, he was only one of the four partners of Messrs. Johnson & Co. Taking these circumstances into

consideration in assessing the extent of his liability, we think that he should be made liable for a sum of Rs. 10,000.

5. In the result, C.M.A. No. 501 of 1938 is allowed, and C.M.A. No. 502 of 1938 and C.M.A. Nos.. 576 and 577 of 1938 are modified by

limiting the compensation to Its. 5,000 and 10,000 respectively. We make no order as to costs in C.M.A. Nos. 501 and 502 of 3938 but we

direct the appellant in C.M.A. Nos. 576 and 577 of 1938 to pay the costs of the respondent on the amount decreed. The Official Liquidators will be entitled to take their costs out of the estate.

6. A.A.O. No. 576 of 1938 . having been set down to be mentioned this day the Court made the following

ORDER

7. The only point argued by Mr. Bhujanga Rao was that the decree against his client is not in accordance with the judgment. This matter was dealt

with by the District Judge in paragraph 40 of his judgment. That related to the liability for the value of the shares. . In the judgment the learned

Judge directed that Narasinga Rao should pay half the value of the shares, vie., Es. 2,550 in the first instance and the balance of Es. 2,550 should

be paid by him in case that amount is not recovered from Kanjilala who was made liable for the other half. The decree will accordingly be modified

and this order will be incorporated in the main judgment which we delivered.

