
(2006) 03 DEL CK 0263
In the Delhi High Court
Case No : CS (OS) No. 469 of 1999

Saurabh Exports

APPELLANT

Vs

Blaze Finlease and Credits Pvt. Ltd.

RESPONDENT

Date of Decision : 16-03-2006

Acts Referred:

Citation : (2006) 133 CompCas 495 : (2006) 129 DLT 429 : (2006) 89 DRJ 372 : (2006) 2 RCR(Civil) 786 : (2006) 72 SCL 321

Hon'ble Judges : Sanjay Kishan Kaul, J

Bench : Single Bench

Advocate : Ujjwal Kr. Jha and S.K. Pradha, for the Appellant; B.L. Anand, for the Respondent

Judgement

Sanjay Kishan Kaul, J.—The plaintiff has filed a suit for recovery of Rs.21,00,650/- against the defendants jointly and severally. The plaintiff is the proprietorship concern of Smt. Prabha Uppal and claims to be engaged in the business of exports. Defendant No. 1 is the private limited company stated to be engaged in the business of leasing and financing having been incorporated on 17.08.1995. Defendants No. 2 and 3 are the Directors of defendant No. 1 company while defendant No. 4 is the husband of defendant No. 3 and the brother of defendant No.2. It is stated in the plaint that the subscribed capital is held by defendants No. 2 and 3 being 10 equity shares each amounting to the total amount of Rs.100/- for each of the defendants.

2. In November, 1996, defendant No. 4 is stated to have approached Mr. Virendra Uppal, Authorised Representative of the plaintiff firm and the brother-in-law of Smt. Prabha Uppal stating that defendant No. 1 company was inviting short-term deposits at good interest rates. Defendant No. 4 is stated to have represented that his brother and wife are also the Directors of defendant No. 1 company. The plaintiff made a deposit of Rs.15 lakhs in the name of defendant No. 1 company for a period of six months with interest @ 18% p.a. in pursuance to a cheque No. 681911 dated 22.11.1996 drawn on Syndicate Bank, Kirti Nagar, New Delhi to

carry interest @ 18% p.a.

3. The plaintiff claims to have demanded the money back in March, 1997 and after considerable persuasion cheque No. 296473 dated 25.03.1997 for Rs.15 lakhs drawn on Allahabad Bank, Parliament Street, New Delhi was issued on behalf of defendant No. 1 company and signed by defendant No. 2. However, the plaintiff firm was apparently asked not to present the cheque with the assurance of payment of further interest. The plaintiff states that acting in good faith and relying upon the representations made by the defendants, the cheque was not presented for encashment. The time-period for presentation of the cheque expired, but other than promise from the defendants, nothing came out. The plaintiff has, thus, sued for the said amount along with overdue interest.

4. A common written statement has been filed on behalf of defendants No. 1 to 3 while a separate written statement was filed by defendant No. 4. The liability of defendant No. 1 to pay the amount is not disputed, but it has been stated that defendant No. 1 company is almost defunct as it suffered losses due to unavoidable circumstances. Defendants No. 2 and 3 have denied their liability on the ground that there is no personal liability of the said Directors as the deposit was received in the name of defendant No. 1 company. Defendant No. 4 has denied the liability on the ground that it had nothing to do with the transaction in question as he was neither a Director nor a share-holder of defendant No. 1 company. However, it is not disputed that the said defendant is the husband of defendant No. 3, Director of defendant No.1 company.

5. On the pleadings of the parties, the following issues were framed on 17.01.2003:

1. Whether the suit filed by the plaintiff is bad for misguide of parties in view of Preliminary Objection Nos. 1 and 2 taken by the defendants in their written statement? OPD

2. Whether defendants No. 2 to 4 are personally liable for the amount claimed in the plaint? OPP

3. At what rate of interest the plaintiff deposited the amount with the defendants? OPP

4. Relief.

6. The plaintiff produced two witnesses to substantiate its plea being Smt. Prabha as PW-1 and Virendra Uppal as PW-2. Defendant No. 2 appeared in the witness box as DW-1 while defendant No. 4 appeared in the witness box as DW-1.

7. A perusal of the testimony shows that DW-2 has stated that defendant No. 4 had nothing to do with the transaction in question. In response to specific questions about the functioning of the company, its Directors and its accounts, DW-2 was vague and evasive. Defendant No. 4 (DW-1) denied any liability and stated that he had nothing to do with the transaction in question. It is, however,

not in dispute that there was long-term family relationships between the Uppals and Nagpals.

8. On consideration of the submissions of learned counsel for the parties and on perusal of the pleadings, the evidence and the documents on record, I now proceed to give the findings on the issues.

ISSUE NO. 1 :-

9. The first issue arises from the plea that the suit is bad for mis-joinder of parties on account of impleadment of defendant No. 4 in the suit. Since defendant No. 4 is neither a shareholder nor a Director of defendant No.1 company. The onus was put on the defendants to prove the said issue. A perusal of the averments contained in the plaint shows that the case set up is that it is defendant No. 4 who approached the plaintiff and whether defendant No. 4 can be made liable on the basis of the material on record is a different aspect. It is also relevant to note that one of the documents produced in evidence is a confirmation letter dated 06.05.1998 (Ex. PW-1/P-1). This document was issued by the plaintiff company and the confirmation was signed by defendant No. 4. It is, however, relevant to note that while signing the said letter, defendant No. 4 had deleted the word "Director" put under his name while signing on behalf of defendant No. 1 company. In his testimony, defendant No.4 had stated that other than this document, he had not signed any other document on behalf of defendant No. 1 and the said document was signed at the request of the plaintiff.

10. The aforesaid facts show that the suit cannot be stated to be bad for misjoinder of defendant No. 4 in the suit even if the plaintiff is not able to ultimately succeed against the defendants. The issue is answered in favor of the plaintiff.

ISSUE NO. 2 :-

11. This is the principal issue arising in the suit on account of the fact that the plaintiff seeks to make recovery against defendants No. 2 to 4 personally for the amount advanced to defendant No.1. Defendants No. 2 and 3 are Directors while defendant No.4 is only the husband of defendant No. 3. It is no doubt true that witnesses of the plaintiff had stated that defendant No. 4 is the one who had approached for the grant of loan facility / deposit, but it is also true that there is no document signed by defendant No. 4 in his personal capacity. In fact, the only document which bears the signature of defendant No. 4 is Ex. DW-1/P-1 where defendant No. 4 has signed for defendant No. 1 company, though not as a Director. Even if the plaintiff has advanced the loan on good faith, the legal liability cannot be fixed on defendant No. 4 for the reason that defendant No. 4 is not party to the transaction and not having any locus in defendant No. 1 company. Thus, I am unable to hold that defendant No. 4 would be liable for the transaction.

12. Insofar as defendant No. 3 is concerned, she is a Director-shareholder of

defendant No. 1 company. She is the wife of defendant No. 4 and the sister-in-law of defendant No. 2. The testimonies of the defendants show that the said defendant being a house-wife had a little role to play in defendant No. 1 company. This, in fact, also the stand of the witnesses of the plaintiff. In such a situation, on the ground of piercing the corporate veil, defendant No. 3 cannot be made liable.

13. The only question, thus, to be considered is of the liability of defendant No. 2 on the submission of learned counsel for the plaintiff that it is a fit case where the corporate veil should be lifted.

14. The letter dated 22.11.1996 issued by the plaintiff to the defendant enclosing the cheque for Rs.15 lakhs has been proved as Ex. P-1 while the cheque of repayment dated 25.03.1997 has been proved as Ex. P-2. The cheque itself is Ex. P-3. The latter two documents are signed by defendant No. 2 though on behalf of defendant No. 1 company. Interestingly, the letter dated 21.01.1998 (Ex. P-1/4) addressed by the plaintiff to the defendant regarding the refund of deposit is drawn to the attention of defendant No. 4. This letter set out that since the clearance did not come till May, 1997 and defendant No. 1 had pleaded financial stress, the cheque had not been presented. The cheque was not being replaced and request for payment was made. Learned counsel for the plaintiff contends that the social relationship between the parties is not disputed and defendant No. 1 company is nothing, but a front for the remaining defendants. Learned counsel, thus, contends that the corporate veil is liable to be lifted as a view to the contrary would amount to a premium on the fraud which has been played by the defendants on the plaintiff. In this behalf, learned counsel referred to judgment of the Supreme Court in *Singer India Ltd. Vs. Chander Mohan Chadha and Others*, where it has been observed in paras 14 and 15 as under:

14. In *Palmer's Company Law* (24th Den.), in Chapter 18, para 2 onwards some instances have been given in which the modern company law disregards the principle that the company is an independent legal entity and also when the courts would be inclined to lift the corporate veil and the important ones being in relation to the law relating to trading with the enemy where the test of control is adopted and also where the device of incorporation is used for some illegal or improper purpose. In *Gower: Principles of Modern Company Law* (4th Edn.), in Chapter 6, the topic of lifting the veil has been discussed. The learned author has said that there is no consistent principle beyond a refusal by the legislature and the judiciary to apply the logic of the principle laid down in *Salomon* case where it is too flagrantly opposed to justice, convenience or the interest of the Revenue. In the cases where the veil is lifted, the law either goes behind the corporate personality to the individual members, or ignores the separate personality of each company in favor of the economic entity or ignores the separate personality in favor of the economic entity constituted by a group of associated companies. The principal grounds where such a course of action can be adopted are to protect the interest of the Revenue and also where the corporate personality is

being blatantly used as a cloak for fraud or improper conduct.

15. The question of lifting the corporate veil was examined by a Constitution Bench in *Tata Engg. and Locomotive Co. Ltd. v. State of Bihar*. The Court observed that the doctrine of lifting of the veil postulates the existence of dualism between the corporation or company on the one hand and its members or shareholders on the other. After review of a number of authorities and standard books, the parameters where the said doctrine could be applied were indicated in consonance with the principles indicated in the preceding paragraph. In *Delhi Development Authority v. Skipper Construction Co. (P) Ltd.* Mr. Justice B.P. Jeevan Reddy has examined the question in considerable detail and it will be useful to reproduce the relevant paragraph of the judgment which is as under (SCC pp. 637-38, para 24)

Lifting the corporate veil

24. In *Salomon v. Salomon & Co. Ltd.* the House of Lords had observed, the company is at law a different person altogether from the subscribers ...; and though it may be that after incorporation the business is precisely the same as it was before, the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by that Act."

Since then, however, the courts have come to recognise several exceptions to the said rule. While it is not necessary to refer to all of them, the one relevant to us is "when the corporate personality is being blatantly used as a cloak for fraud or improper conduct". [Gower: *Modern Company Law* " 4th Edn. (1979) at p. 137.] Pennington (*Company Law* - 5th Edn., 1985 at p. 53) also states that "where the protection of public interests is of paramount importance or where the company has been formed to evade obligations imposed by the law", the court will disregard the corporate veil."

It was held that, broadly, where a fraud is intended to be prevented, or trading with the enemy is sought to be defeated, the veil of corporation is lifted by judicial decisions and the shareholders are held to be persons who actually work for the corporation". The main principle on which such a course of action can be taken was stated in paragraph 28 of the Report and the relevant part thereof is being reproduced below: (SCC p. 639)

28. The concept of corporate entity was evolved to encourage and promote trade and commerce but not to commit illegalities or to defraud people. Where, Therefore, the corporate character is employed for the purpose of committing illegality or for defrauding others, the court would ignore the corporate character and will look at the reality behind the corporate veil so as to enable it to pass appropriate orders to do justice between the parties concerned.

15. The present case is not one where there is some illegal or improper purpose,

but the plaintiff is desirous of bringing this case within the parameters of one where the corporate personality is being blatantly used as a cloak for fraud or improper conduct". Learned counsel contends that defendants No. 2 to 4 cannot evade the responsibility and liability behind the cloak of defendant No. 1 company. In this behalf, learned counsel contends by reference to the aforesaid observations that the Court should ignore the corporate character and look at the reality behind the corporate veil.

16. Learned counsel emphasised the fact that defendant No. 1 company was in the nature of a family company and, thus, where the actual nature of transaction was a loan or deposit with all the defendants, the cloak of defendant No. 1 should not be used to defeat the claim of the plaintiff and in this behalf referred to the observations of the Supreme Court in *Subhra Mukherjee and Another Vs. Bharat Coking Coal Ltd. and Others*, where in para 11, it was observed as under:

11. Mr. Srivastava submitted that undue emphasis was given to the fact that the Directors of the Company were brothers and the appellants are their wives. He argued that the Company is a separate legal entity which is independent of its Directors and shareholders and repeatedly referred to the quoted decision in *Salomon v. Salomon*. The principle laid down in *Salomon* case more than a century ago in 1897 by the House of Lords that the company is at law a different person altogether from the subscribers who have limited liability, is the foundation of joint stock company and a basic incidence of incorporation both under English law and Indian law. Lifting the veil of incorporation under statutes and decisions of the courts is an equally settled position of law. This is more readily done under American law. To look at the realities of the situation and to know the real state of affairs behind the facade of the principle of the corporate personality, the courts have pierced the veil of incorporation. Where a transaction of sale of its immovable property by a company in favor of the wives of the Directors is alleged to be sham and collusive, as in the instant case, the court will be justified in piercing the veil of incorporation to ascertain the true nature of the transaction as to who were the real parties to the sale and whether it was genuine and bona fide or whether it was between the husbands and the wives behind the facade of separate entity of the company. That is what was done by the High Court in this case.

17. I am in agreement with the submission of learned counsel for the plaintiff insofar as the liability of defendant No. 2 is concerned. Defendant No. 2 was extremely evasive during his cross-examination. Defendant No. 2 as DW-2 stated that the building, namely, Sunder Plaza where defendant No. 1 company had its office was demolished by the MCD in the year 1997. He further stated that after demolition, there was no registered office of defendant No. 1 and the company was not functional for about the last two years. He even denied the knowledge about filing of returns or signing balance-sheets though he admitted to signing the acknowledgment of deposits as Director of defendant No. 1 company. The witness also did not remember whether any permission from the Reserve Bank of

India was sought for seeking deposits. He admitted to Mr. Virendra Uppal being a family friend who had approached him for the deposit.

18. In reply to para 2 of the plaint setting out the fact that defendants No. 2 and 3 are the Directors of the company holding 10 equity shares each of Rs.10/- amounting to Rs.100/- each, the same are unconditionally admitted in the written statement. It is, thus, obvious that defendant No. 1 company was only a front for the business of defendant No. 2. The role of defendant No. 4 could not clearly emerge in view of the evidence placed on record though he did execute certain document on behalf of defendant No. 1. Defendant No. 4 also did not have any standing on paper in defendant No. 1 company though his wife defendant No. 3 was a Director. Defendant No. 3 is only a house-wife and did not even appear in the witness box. It is, thus, obvious that defendant No. 2 was running the business in the name of defendant No. 1 company possibly with the help of defendant No. 4.

19. The loan deposit is not disputed nor the lack of repayment thereof. I am unable to accept the plea of learned counsel for the defendants that the plaintiff ought to have presented the cheque handed over and, thus, an adverse inference should be drawn against the plaintiff. No depositor would refrain from depositing the refund cheque unless asked not to do so. The plaintiff had categorically stated that there were instructions not to deposit the cheque. To dispel this impression, defendant No. 2 could have easily produced the account statement of defendant No. 1 company against which the cheque was issued to show that there was a balance standing to meet the commitment as per the cheque issued. Defendants No. 1 and 2 failed to do so.

20. I am, thus, of the considered view that the principles laid in the judgments referred to aforesaid for lifting of the corporate veil are satisfied in the present case. It has already been observed that the concept of corporate entity was evolved to encourage and promote trade and commerce, but not to defraud people. The present case is one where clearly the plaintiff is sought to be defraud of the amount of Rs.15 lakhs under the cloak of a corporate entity of defendant No. 1 company and, thus, such a corporate veil must be lifted especially taking into consideration that defendant No. 1 company was only a family arrangement of the remaining defendants.

21. Issue No. 2 is, thus, answered in favor of the plaintiff to the extent that defendant No. 2 is held personally liable apart from defendant No. 1.

ISSUE NO. 3 :-

22. The question of the rate of interest is not in dispute since in the cross-examination of defendant No. 2 as DW-2, the witness has clearly admitted that the rate of interest was 18% p.a. It is, thus, held that defendants No. 1 and 2 are liable to pay interest on the principal amount. However taking into consideration the declining rates of interest over the period of time, I am inclined to grant pendente lite interest @ 15% p.a. and future interest @ 12% p.a.

RELIEF :-

23. A decree for a sum of Rs.21,00,650/- along with simple interest @ 15% p.a. from 22.11.1996 (i.e., the date of deposit) till the date of decree and @ 12% p.a. from the date of decree till the date of realisation on the principal amount of Rs.15 lakhs is passed against defendants No. 1 and 2 jointly and/or severally. The plaintiff shall also be entitled to costs.

24. Decree-sheet be drawn up accordingly.