(1971) 04 MAD CK 0016

In the Madras High Court

Case No : Appeal Against Order No''s. 302 and 347 of 1970

S.N. Vr. Ct. Chinnan Chettiar and Others — APPELLANT

Vs

Official Receiver — RESPONDENT

Date of Decision : 12-04-1971

Acts Referred:
Companies Act, 1913 — Section 177B(2), 196(1)

Citation : (1971) 41 CompCas 914 : (1971) 84 LW 667 : (1971) 2 MLJ 490

Hon'ble Judges : Ramanujam, J

Bench : Single Bench

Advocate : T.R. Srinivasan and K. Ramamurthy, for the Appellant; A.C. Munuswami Reddy, for the Respondent

Final Decision : Allowed

Judgement

Ramanujam, J.—These are two appeals filed against the orders of the District Court, Madurai, in C.M.P. No. 350 of 1958 in O.P. No. 97

of 1955, High Court, Madras, ordering a public examination of the appellants herein under ~ 196 of the Indian Companies Act, As both the

appeals arise out of the same order, they are dealt with together. A public limited company by name, Madurai Srinivasa Mills Ltd., was floated in

the year 1946 as a textile mill and the certificate of incorporation was issued on January 17, 1946. Originally the firm of M/s. Srinivasan and Co.

was acting as the managing agents of the said company. There were three partners in that firm, Narayanan Chettiar, Chinnan Chettiar and Mani

lyer. The said partners of the firm were also the directors of the company, and the managing agency agreement between the company and the said

firm of Srinivasan and Company provided that the firm should be the managing agents of the mills for a period of 20 years. For locating the mills an extent of 30 acres of land was purchased and in some portions of those lands buildings were raised up to the roof level and in some portions up to

the ground level. But, after some time, troubles arose between the three partners of the managing agency firm and as a result thereof one P. S.

Thirumalai Iyengar was taken in as ah additional partner of M/s. Srinivasan and Company and he took charge of the mill in June, 1948, as

managing partner instead of P. S. Mani Iyer who was earlier in charge of the mill as the managing partner of the managing agency firm.

2. After Thirumalai Iyengar took charge, he examined the accounts and found that some amounts belonging to the mills had been diverted by the

three partners of the firm for purposes other than the affairs of the mills and, therefore, he obtained a promissory note for a sum of Rs. 1,78,000

from the then three partners of the managing agency firm towards their alleged liability, and he also filed a criminal complaint against the said three

persons for offences u/s 420, Indian Penal Code. The partners were convicted by the trial court but on appeal the conviction was set aside.

Thereafter, the directors of the mills at the instance of the said Thirumalai Iyengar passed a resolution to the effect that the previous three partners

of the managing agency firm ceased to be directors of the company u/s 86(d) of the Indian Companies Act as they had been indebted to the

company to the tune of Rs. 1,78,000. Thereafter, the three partners filed a suit, O.S. No. 228 of 1949, before the Sub-Court, Madurai, for a

declaration that they continue to be directors. Thirumalai Iyengar in his turn filed a suit, O.S. No. 82 of 1951, on behalf of the company for

recovery of the sum of Rs. 1,78,000 said to be due on the promissory note executed by them. When those suits were pending, a creditor of the

company filed O.P. No. 365 of 1953 before this court for the winding up of the company. But that petition was allowed to be dismissed as one of

the partners of the managing agency firm, Narayanan Chettiar, paid off that creditor and some others. Subsequently, O.S. No. 228 of 1949 was

decreed and O.S. No. 82 of 1951 was dismissed.

3. In view of these disputes between the partners of the managing agency firm, further work of constructing the mills came to a standstill and three

of the shareholders filed O.P. No. 97 of 1955 before this court for the winding up of the company on the ground that the business of the company has been suspended, and that there were irregularities and fraud in the conduct of the affairs of the company. The company was ordered to be

wound up on September 26, 1955, and the official receiver, Madurai, was appointed as official liquidator for the administration of the affairs of the

company. The official liquidator took possession of the assets of the mills on October 1, 1955. When he took charge he found that the entire share

capital of Rs. 9,43,425 has been spent away and he also found a sum of Rs. 1,05,875 as the amount due from the company to the various

creditors. The official liquidator stated in his report that the following factors lead to the necessary inference of the commission of fraud in the

course of the formation and promotion of the company and in the subsequent dealings with the properties of the company.

(1) fraud in the collection of share capital and allotment of shares;

(2) fraud in the investment of the share capital amount;

(3) fraud in the purchase of lands ;

(4) fraud in the purchase of building materials ;

(5) fraud in advancing monies for purchase of materials, etc., required for the mills;

(6) fraud in the sale of machinery and Government securities, furniture, livestock, etc., belonging to the mills ;

(7) fraud in the disposal of monies obtained by such sale ;

(8) fraud in the payment of premiums for the financial aid ;

(9) fraud in effecting compromise with Sri G. Srinivasa Iyer, architect and engineer;

(10) fraud in maintaining accounts; and

(11) fraud on resolutions passed by the directors at the instance of the managing agents.

4. The official liquidator, therefore, prayed that the ex-directors and the managing agents were all to be publicly examined under the provisions of

Section 196 of the Indian Companies Act. This application of the official liquidator was opposed by the ex-directors and the managing agents of

the company. The lower court directed the public examination of all the directors as also the partners of the managing agency firm u/s 196 of the

Indian Companies Act. Against that order, the present appeals have been filed by

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Chettiar, who were admittedly the partners of the managing agency firm, and M. U. Krishna Iyer and V.D.M.R.M.M. Muthiah Chettiar, who were

merely the directors of the company, contending that the lower court was in error in ordering their public examination while in fact they were not

directly in management of the affairs of the company or of the managing agency firm.

5. So far as Chinnan Chettiar and Narayanan Chettiar are concerned, they contended that though they were partners of the managing agency firm,

they were not directly in charge of the affairs of the mills, but one, P. S. Mani Iyer was originally the managing partner of the managing agency firm

and he was in complete charge of the mills, that later on Thirumalai Iyengar became the managing partner and he was in complete management of

the mills, and that no allegation of fraud has been directly attributed to any of them and, as such, Section 196 of the Indian Companies Act cannot

be invoked in their cases. As regards the other two appellants, it is contended that they were merely the directors of the company and that they

had nothing to do with the management of the mills as such, that there cannot be any question of fraud being committed by them in the management

of the business of the mills and that, therefore, the order of the lower court directing their public examination cannot be sustained. The question,

therefore, is whether there should be a public examination of all the appellants herein u/s 196 of the Indian Companies Act, 1913.

6. Section 196(1) of the Indian Companies Act is as follows:

When an order has been made for winding up a company by the court, and the official liquidator has applied to the court stating that in his opinion

a fraud has been committed by any person in the promotion or formation of the company or by any director or other officer of the company, in

relation to the company since its formation, the court may, after consideration of the application, direct that any person who has taken any part in

the promotion or formation of the company, or has been a director, manager or other officer of the company shall attend before the court on a day

appointed by the court for that purpose, and be publicly examined as to the promotion or formation or the conduct of the business of the company,

or as to his conduct and dealings as director, manager or other officer thereof.

7. Section 177B(2) provides:

The official liquidator may also, if he thinks fit, make a further report, or further reports, stating the manner in which the company was formed

and, whether in his opinion any fraud has been committed by any person in its promotion or formation, or by any director or other officer of the

company in relation to the company since the formation thereof, and any other matter which in his opinion it is desirable to bring to the notice of the

court.

8. A conjoint reading of the above provisions shows that the official liquidator has to bring to the notice of the court any fraud that might have been

committed by any person in the promotion, formation or management of the company, and the court is empowered to order public examination of

the persons charged with fraud at the instance of the official liquidator. The provision with regard to the public examination was first introduced into

English company law by the Companies (Winding up) Act of 1890 and Sections 8(2) and 8(3) of that Act corresponded to Sections 177B(2) and

196 of our Companies Act of 1913. The question as to when the court will be justified in ordering public examination has been considered in

several decisions of English as well as Indian courts. The leading case on the subject is that of the House of Lords in Ex parte Barnes. In that case

while considering the jurisdiction of the court to direct public examination of a person u/s 8(3) of the Companies (Winding up) Act, which is similar

to Section 196 of the Indian Companies Act, 1913, Lord Halsbury L.C. observed:

In the event of there being no fraud found or in the event of there being no individual pointed out as being suggested to be guilty of fraud, I

entertain no doubt that the court has no jurisdiction to make any such order for a public examination......and, inasmuch as it is directed to that

person and that person alone it seems to me that it follows as essential to the jurisdiction of the court that there should be a preliminary finding,

which is the foundation of that jurisdiction, namely, that fraud has been committed by the individual person who is pointed out by the report.

9. The above decision was followed in In re Civil Naval and Military Out fitters Ltd. and it was expressed therein regarding the report of the

official receiver that it was not meant to be an indictment or a statement of claim to charge a man with fraud and that the object of the report was to raise a prima facie case of fraud, not a case which a man had to answer finally, but a case upon which a judge had to decide whether he was to

undergo a public examination. The Judicial Committee had to consider the question in Musabhai Noormohamed Tejani v. Official Receiver,

whether fraud should be attributed to each of the respondents before their public examination is ordered and while negativing the contention that a

prima facie case must be made out before any public examination could be made and that the official receiver''s report must attribute to each of

several persons ordered to attend some particular piece of alleged fraud, the court expressed as follows:

......this appears to their Lordships to compel the conclusion that if a company with, say, three directors was carrying on some business in a

fraudulent manner, none of the directors could be brought to book unless he or they chose to tell the official receiver which of the three directors

had been the actual perpetrator or perpetrators of any of the fraudulent acts in question. This would be a reductio ad absurdum which their

Lordships find impossible of acceptance.

10. Chagla C.J. in Fazal Ibrahim Rahimtoola v. Appabhai G. Desai stated that looking to the whole scheme of the Act and of Section 196, it is

clear that Section 196 only aims at those persons who are charged with fraud and not those persons who may be concerned with the working of

the company and are not charged by the liquidator with fraud. In In re Indian States Bank Ltd., it has been held that the court before it passes an

order for public examination must be satisfied that some facts are given in the application which entitle the court to find that there is a prima facie

case of fraud against the particular person named, and that the general allegations of fraud in the management of the company may not be sufficient

for ordering for the public examination of any person not directly implicated in the fraud, but that there is no necessity to specify the charge of fraud

with the same particularity as would be necessary in a criminal charge under the Penal Code. In In re Central Tipperah Tea Co. Ltd. the

considerations that are to be taken into account by the court when ordering public examination at the instance of the official liquidator have been

fully set out. It is pointed out that the only matter for consideration of the court, on the report of the liquidator, is whether on the basis of the report of the liquidator an order for public examination has to be made and against which of the directors; in other words whether the liquidator is justified

in making a finding of fraud against the directors or any of them on the materials in the report prepared by him. If the materials in the report disclose

a prima facie case of fraud, the court should make an order for public examination. It is not necessary for the court at that stage to adjudicate upon

the question whether the directors are guilty of the fraud alleged and such questions have to be considered only after the public examination and the

concerned directors will get ample opportunity of controverting or denying the allegations of fraud in the course of the public examination and that

the court has got jurisdiction to make an order for public examination if the following three condition their being the directors of the company. Even

though they have not acted as managing partners of the managing agency firm, they had subsisting and substantial nexus with the management of the

company and as such the allegations made by the official liquidator in relation to instances Nos. 1 to 10 can be said to show a prima facie case of

fraud against them. I am not, therefore, in a position to interfere with the order of the lower court ordering their public examination.

12. However, in respect of the other appellants, M.U. Krishna Iyer and V.D.M.R.M.M. Muthiah Chettiar, it is seen that they were merely

directors of the company without taking part in the management of the company and they are said to have passed resolutions brought in by the

managing agents. As already stated, that will not form the basis of a charge of fraud and there is no material available in the official liquidator''s

report to show that they passed the resolutions with any fraudulent intention. Hence I cannot agree with the lower court that a charge of fraud has

been made out against them. The order for their public examination cannot, therefore, be sustained.

13. In the result, C.M.A. 302 of 1970 is allowed in part in so far as it relates to the third appellant (M.U. Krishna Iyer) and in other respects the

order of the lower court is affirmed. C.M.A. 347 of 1970 filed by V.D.M.R.M.M. Muthiah Chettiar is allowed. No costs. The respondent in both

the appeals is entitled to a sum of Rs. 250 to come out of the company.

