

(1966) 02 MAD CK 0006

In the Madras High Court

Case No : Company Application No. 233 of 1965 in C.P. No. 21 of 1961

The Official Liquidator, Madras

APPELLANT

Vs

C.V. Raman and three others

RESPONDENT

Date of Decision : 24-02-1966

Acts Referred:

Companies Act, 1956 — Section 145, 455, 455(2), 478, 8
Constitution of India, 1950 — Article 20(3), 20(3)

Citation : (1966) 36 CompCas 701

Hon'ble Judges : Kailasam, J

Bench : Single Bench

Advocate : G.N. Chary for Respt. No. 1, Mr. M.S. Venkatarama Ayyar for Respt. No. 2, Messrs. T.B. Balagopal and K.S. Sankara Ayyar for Respts. Nos. 2 to 4, for the Respondent

Final Decision : Allowed

Judgement

Kailasam, J.—This application is taken out by the Official Liquidator, Madras High Court, the Official Liquidator of Manasuba & Company

(P.), Limited under Ss. 455 and 478 of the Companies Act, 1956 for directing the public examination of the three directors, namely, C. V. Raman,

T. V. Narayanaswami Aiyar and T.K. Balasubramaniam, and the Secretary of the Company, R.S. Rangarajan. The company, Manasuba &

Company (Private) Limited, was incorporated on 13th May, 1957, under the Companies Act, 1956 as a private limited company. It ceased to do

business as from 21st May, 1961. It was ordered to be wound up. A preliminary report under S. 455 of the Companies Act was tiled on 17th

December, 1962, by the Official Liquidator and was ordered by this Court on 25th January, 1963. The Official Liquidator filed a further report

under S. 455(2) stating that fraud had been committed in the conduct of the

business of the company and that a public examination of the persons mentioned above should be conducted.

2. The three persons C.V. Raman, T.V. Narayanaswami Aiyar and T.K. Balasubramaniam, and one T.N. Nagarajan, were the promoter-

directors of the company. Nagarajan subsequently resigned his post as director. C.V. Raman was appointed Managing Director of the Company

in charge of all business by a resolution of the company dated 24th September, 1957, and was paid a sum of Rs. 550 per month from 1st

September, 1957, as salary for managing the company's affairs. Narayanaswami Aiyar, who was another promoter-director of the company, was

paid Rs. 325 per month as salary for advising the company in the matter of providing finances for various works, contracts etc. His salary was

increased to Rs. 550 per month with effect from 1st June, 1958. He acted as Chairman at the meetings of the Board of Directors at all material

times. Balasubramaniam was also a promoter-director of the company, and by a resolution of the Board dated 6th October, 1958, he was being

paid Rs. 550 per month with effect from 1st May, 1958, for looking after the agency work and canvassing for various agencies and for looking

after the other interest of the Company. Rangarajan was appointed Secretary of the company by a resolution of the Board dated 13th May, 1957,

and was authorised to carry on the day to day affairs of the company taking instructions from any of the directors.

3. The company entered into several contracts for construction of buildings and quarters as well as supply of building and road materials to the

Neyveli Lignite Corporation and the Integral Coach Factory and supplies to the Madras Port Trust etc. As the undertakings by the Company

involved huge expenditure, it was provided in the Articles of Association that the Directors may raise or borrow monies. The Directors by

resolutions permitted the Managing Director to do various acts and subsequently ratified those acts of the Managing Director. The company

passed various resolutions for borrowing moneys from several banks like the Bank of Baroda, Pandyan Bank, Indian Bank, etc. In pursuance of

those resolutions large amounts were borrowed.

4. Apart from these borrowings the company indulged in several transactions which are not permissible in law. The company purchased two ears

and twenty-one lorries. The company had paid the full price only for a few of these vehicles. With regard to the other vehicles, the company would appear to have paid only small amounts by way of advance and the balance was paid by borrowing from certain financing firms and Multani money-lenders, by executing hypothecation deeds in favour of the Banks and hire purchase agreements in favour of the financing firms and the individual financiers.

5. The company also borrowed from banks by discounting bills for supply of materials to public concerns like Neyveli Lignite Corporation, the Integral Coach Factory, Madras Port Trust, etc. It was found that several of the documents connected with the borrowings from several banks appeared to be not genuine and contained forged signatures of the directors. The affairs of the company also disclosed that that the company was negligent in fulfilling its contracts. Due to lack of proper supervision several undertakings were not satisfactorily carried out and various supplies effected by the company were found to be of substandard. As a result the institutions concerned preferred counter claims.

6. S. 455(2) of the Companies Act, 1956, runs as follows:

The Official Liquidator may also, if he thinks fit, make a further report, or further reports, stating the manner in which the company was promoted or formed and whether in his opinion, any fraud has been committed by any person in its promotion or formation, or by any officer of the company in relation to the company since the formation thereof, and any other matters which, in his opinion, it is desirable to bring to the notice of the Court.

7. On receiving such a report the Court is empowered to proceed under S. 478 of the Act, which is as follows:

When an order has been made for winding up a company by the Court, and the Official Liquidator has made a report to the Court under this Act, stating that in his opinion a fraud has been committed by any person in the promotion or formation of the company or by any officer of the company in relation to the company since its formation, the Court may, after considering the report, direct that that person or officer shall attend before the Court on a day appointed by it 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 an officer thereof.

8. Sections 455 (2), 478, together prescribe the circumstances in which a public examination can be conducted. Under S. 455 (2) the Official

Liquidator shall make a further report stating that in his opinion a fraud has been committed by any person in the promotion or formation of the

company or by any officer of the company in relation to the company since the formation thereof. The fraud contemplated must be by a person in

the promotion or formation of a company or by any officer of the company in relation to the company. S. 478 empowers the Court, when it is

satisfied that a fraud has been committed by a person in the promotion or formation of the company or by any officer of the company in relation to

the company in its formation, to direct that person or officer to be publicly examined. Before a public examination could be directed against any

person, that a person in the opinion of the Official Liquidator should have committed a fraud. That fraud should have been in the promotion or

formation of the company or by any officer of the company in relation to the company, since its formation. In this application two contentions are

raised by the learned Counsel appearing for respondents 2, 3 and 4. It is submitted that the fraud, if any, does not relate to the promotion or

formation of the company or by any officer of the company in relation to the company, and that in any event the report of the Official Liquidator

does not disclose that respondents 2, 3 and 4 were in any way concerned with the fraud. The question whether the report of the Official Liquidator

discloses any fraud against respondents 2, 3 and 4 which will make them liable for being publicly examined, may be taken up first.

9. The fraud alleged in the report may be summed up as follows:

(a) The company borrowed large sums of money without any apparent justification;

(b) The company was also grossly negligent in executing several contracts and supplying several sub-standard materials;

(c) The company borrowed large amounts from banks, financing firms and individual financiers on executing hypothecation deeds or hire purchase

agreements; it is found on examination that the moneys had been raised on one and the same vehicle from several financiers without the knowledge

of the prior encumbrances of the said vehicle; the borrowings were effected on production of documents which were forged and not genuine ;

(d) The company borrowed by discounting bills for supply of materials to public concerns like the Neyveli Lignite Corporation, Integral Coach

Factory, Madras Port Trust etc. Some of the documents connected with the borrowings from the several banks appear to be not genuine and

contain forged signatures of the directors.

10. It is admitted that the 1st respondent, C.V. Raman, was the Managing Director and was put in charge of all business and was Managing the

company's affairs. The 2nd respondent was paid a salary of Rs. 550 from 1st June, 1958, and was the Chairman at the meetings of Board of

Directors. The 3rd respondent was also receiving a salary of Rs. 500 per month from 1st May, 1958, and was looking after the various works and

was canvassing for various agencies. The 4th respondent who was the Secretary of the company, was authorised to carry on the day to day affairs

of the company. It is common ground that the company passed various resolutions, for taking loans from the banks, and several loans were

obtained in pursuance of the resolutions. These resolutions and the borrowings were ratified by all the Directors. The plea of respondents 2, 3 and

4 is that the entire management of the company was in the hands of the 1st respondent, the Managing Director, and that they were not aware of the

real affairs of the company and that all the illegal acts were committed by the Managing Directors without their knowledge.

11. That a fraud was committed in the affairs of the company does not admit of any doubt. The report of the Official Liquidator discloses that loans

had been obtained from various financiers by pledging the same vehicle again without the subsequent encumbrances knowing that the vehicle had

already been pledged. It can also admit of no doubt that various spurious bills purporting to be payable by public concerns like Neyveli Lignite

Corporation, the Integral Coach Factory, Madras Post Trust etc., were produced before the banks and loans obtained. The report of the Official

Liquidator clearly justifies his opinion that a fraud had been committed in the affairs of the company and that the 1st respondent was mainly

responsible for it. But so far as respondents 2, 3 and 4 are concerned, it has to be considered whether there is any material for coming to the

conclusion that they were parties to the fraud. No specific act of fraud is alleged by the Official Liquidator against respondents 2, 3 and 4. The

Official Liquidator has stated in his report as follows:

It is also a matter for investigation as to how far the Directors would be individually liable for the loss and the failure of the business....It is

submitted that the conduct of the Managing Director was fraudulent and that of the other directors was, at any rate, grossly negligent and they

acted contrary to their duty as Directors of the company. Even if it were to be assumed they had not directly participated in the Managing

Director's fraudulent acts, they would be liable to reimburse the company for the loss caused thereby.....they have failed to perform their duty to

the company and committed misfeasance in permitting the Managing Directors, either willingly or negligently to commit the aforesaid acts.....The

other directors should have been aware that the Managing Director was acting improperly and in excess of his authority.

12. In the conclusion of the report the Official Liquidator has expressed his opinion that fraud has been committed in the conduct of the business of

the company. He has not stated that in his opinion respondents, 2, 3 and 4 were in any way concerned with the fraud. It was submitted that it was

unnecessary for the Official Liquidator to state in his report the case against each of the persons and that it was sufficient if it was clear from the

facts disclosed that respondents 2, 3 and 4 were jointly responsible for the fraud.

13. The question as to the liability for being publicly examined has been considered in several decisions and they may be referred to the leading

case on the subject is that of the House of Lords reported in *Ex parte Barnes L.R.* (1896) A.C. 146. In considering the jurisdiction of the Court to

direct the public examination of a person under S. 8, Sub-S. (3) of the Companies (Winding-up) Act, which is similar to the provision of Ss. 455

(2), 478 of the Companies Act, Lord Halsbury, L.C., observed as follows:

If all these provisions have reference to a person who is incriminated by the report, and who is brought there in the position of a person against

whom a suggestion is made that he has been guilty of fraud, the whole system, the whole Code thereby created, is intelligible and rational, and one

can understand what the meaning of each part of it is.....But if because a preliminary case has been made against A, as being guilty of fraud, if

because A has been in that sense incriminated by the Official Receiver, B can be summoned and made subject to all these consequences, although

no preliminary charge of fraud has been made against him at all, the whole thing becomes irrational and unintelligible.

14. The learned Judge further 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 be that it follows as essential to the jurisdiction namely, that fraud has been committed by the individual

person who is pointed out by the report.

15. In *In re Civil Natal and Military Outfitters Limited* L.R. (1898) 1 Ch. D. 232, 233, it was held following the decision in *Ex-parte Barnes* L.R.

(18963) A.C. 146, that there must be a report stating the manner in which the company was formed and whether in the opinion of the Official

Receiver fraud had been committed by the person whom he had proposed to examine. Regarding the report of the Official Receiver the Court

observed 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.

16. The Privy Council in *Tejani v. Official Receiver* L.R. (1899) 1 Ch. D. 232, 233, considered the question whether fraud should be attributed to

each of the respondents. It was contended in that case that a prima facie case must be made out before any public examination could be held and

that the Official Receiver's report must attribute to each of several persons ordered to attend some particular piece of alleged fraud. The Privy

Council held at page 431 as follows:-

The need for a prima facie case must surely be satisfied by a prima facie case of the highly qualified kind which was regarded as sufficient by

Lindiey, M.R., in re Civil, Naval and Military Outfitters, Limited L.R. (1899) 1 Ch. D. 232.

17. Regarding the attribution of particular pieces of alleged fraud to particular individuals, the Privy Council observed:

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.

18. Strong reliance was placed on this observation by the Official Liquidator, who contends that the report cannot be expected to disclose which of the directors were the actual perpetrators of the fraudulent act in question. The above observation cannot be read as supporting the contention that, if it is proved that a fraud has been committed in the affairs of the company, every one of the directors is liable to be publicly examined. The report should be of such a nature that will probabalise the opinion of the Official Liquidator that *prima facie* all the directors were concerned in the fraud. If it is made out on the facts that all the directors were jointly concerned in the fraud, it may not be necessary for the Official Liquidator to go further and state which of the directors committed a particular fraud. But in this case on the materials placed before the Court by the Official Liquidator, there is nothing to justify the opinion of the Official Liquidator that respondents 2, 3 and 4 were jointly concerned in the fraud. It is not suggested that respondents 2, 3 and 4 were parties to the fraud of obtaining money by pledging the same vehicle several times over or by producing spurious bills to the banks. There is nothing to indicate that respondents 2, 3 and 4 were parties to the transactions or knew about them in any way. Their drawing salaries would not show that they were privies to the crime. So also the negligence attributed to the company of large borrowings and of not properly supervising the various contracts would not show that they were in any way concerned with the fraud.

19. The next contention of the learned Counsel for the respondents is that the fraud alleged does not relate to the promotion or formation of the company or to the affairs of the company since its formation, and therefore public examination of the respondents cannot be ordered. S. 455 (2) as well as S. 478 of the Companies Act refer to fraud committed by any person in the promotion or formation of the company or by any officer of the company in relation to the company since its formation. The fraud attributed in

the report does not refer to the promotion or formation of the company and that portion of the section is not applicable to the facts of the case. The only question is whether a fraud has been committed by any officer of the company in relation to the company since its formation. It was contended by the learned Counsel for the respondents that the fraud practised by the company on strangers cannot be taken into account. The following observation by Sir Francis Gore-Browne in the Handbook on the Formation, Management and Winding up of Joint Stock Companies at page 721 is relied on:

.....but no account of fraud practiced by the company on strangers will be taken for this purpose.

20. Halsbury's Laws of England, Third Edition, Volume 6, page 570 states the position in the foot-note thus:

The section does not apply where the only charges against the company are in relation to frauds in the course of its business with the outside world, and not connected with its promotion or formation.

21. Buckley on the Companies Act, at page 610 states the position thus:

But the malpractice suggested must be connected with the promotion or formation of the company or the conduct of its affairs in its own economy, not frauds said to have been committed upon the outside world in the course of its business.

22. Again, at page 457 the learned author observes thus:

And a fortiori fraud not connected with the formation or promotion, but against third parties in carrying on the business, does not ordinarily form a ground for a compulsory order by reason of the fact that investigation under such an order would be desirable.

23. Reliance is placed for these statements by Gore-Browne Halsbury and Buckley on the decision reported in *In re Medical Battery Company*

L.R. (1894) 1 Ch. D. 444. In the decision cited on an action against a company to enforce the debentures one Davis, a Chartered Accountant was

appointed receiver on 27th October, 1893. Davis was given liberty to carry on the company business. A petition was presented by a creditor on

27th October asking that the company might be wound up by the Court. Subsequently a resolution was passed by the company that it had been

proved to its satisfaction that it could not by reason of its liabilities continue its

business and that it should be wound up voluntarily and that Davis should be appointed liquidator in such winding up. The petition was amended to include a prayer that the voluntary winding up might be continued under the supervision of the Court and that some other liquidator in the place of Davis might be appointed. When these petitions were pending several articles appeared in the press making serious allegations as to the conduct of the business of the company. The Managing Director on behalf of the company took out action for libel against the publisher of the newspaper. It was urged before the Court that in acting under S. 145 of the Companies Act, 1862, it would have to take into consideration that the rights of the creditors would be prejudiced by the voluntary winding up, not only as regards money results, but also by their exclusion from the benefits conferred by the Companies (Winding up) Act, 1890, and especially the investigation in public under S. 8 of that Act. S. 8 relating to public examination is not applicable to voluntary winding up. The learned Judge, while holding that the creditors would not be prejudiced by not obtaining the benefit of S. 8 of the Act of 1890, observed that it would be wrong to hold that S. 8 was intended to apply to a case where the charges made were brought against the company of having committed frauds in the course of its business with the outside world, and not connected in any way with promotion or formation of the company--that is to say, of its conduct towards persons dealing with it other than shareholders as regards their membership in the company. The above observation of the learned Judge is relied on in support of the contention that a public examination cannot be ordered regarding the conduct of the company towards persons dealing with it other than share borders as regards their membership in the company. It will have to be noted that the learned Judge was dealing only with fraud relating to promotion and formation of the company and not with the clause in S. 8 relating to fraud committed "by any officer of the company in relation to the company since the formation thereof. The fraud that is referred to in S. 455(2) as well as S. 478 of the Companies Act also covers the fraud "by any officer of the company in relation to the company, since the formation". In the case of the officers, the fraud need not relate to promotion or formation of the company. It is sufficient if it is in relation to the company since its formation. It is

contended that "in relation to the company" would only mean fraud by the officer in relation to the company but not as regards outsiders. It is

difficult to accept this contention, for, so far as the officer is concerned, by engaging in illegal activities as in the case of obtaining money on false

pretences for the company, the officer is committing a fraud in relation to the company. The phrase "in relation to" would mean the way in which

one thing is connected with another. The fraud as such is committed by the person as an officer in relation to the company. The contention of the

directors that acts of the company relating to strangers would not come within the purview of S. 478 cannot therefore be accepted. The decision in

In re. Medical Battery Company L.R. (1894) 1 Ch. D. 444 relied on by the learned Counsel for the respondents cannot be of any avail, as it did

not relate to a fraud by the officer in relation to the company after its inception. For the reasons stated I am of the view that there are sufficient

grounds for ordering a public enquiry against the first respondent but not against respondents 2, 3 and 4.

24. So far as the first respondent is concerned, it was contended that his public examination would amount to a testimonial compulsion which is

prohibited under Art. 20(3) of the Constitution of India. Art. 20(3) of the Constitution prohibits compelling a person accused of any offence to be

a witness against himself. The submission of the learned Counsel for the 1st respondent is that a criminal prosecution had been launched against the

first respondent, which had ended in his conviction and that he has preferred a criminal appeal which is pending in this Court. It is submitted that, if

he is subjected to public examination, answers incriminating himself may be extracted, which will gravely jeopardise his chances in the appeal.

Reliance was placed on the decision in In re. Atherton L.R. (1912) 2 K.B.D. 251. The accused in that case a few days before the receiving Order

was arrested in London under the Fugitive Offenders Act, 1881 on a criminal charge and was on remand pending proceedings before a

Magistrate. His public examination was held at the London Bankruptcy Court. The learned Judge referred to the practice in London of not

pressing such questions in relation to the alleged offence while the criminal charge was hanging over the debtor but of adjoining the public

examination until after the trial, and observed that it was only a rule of convenience and tenderness, and that, though followed generally, there might

be occasions where it would be desirable not to follow it. Much reliance cannot be placed on this decision by the first respondent, as the learned

Judge himself has observed that there might be occasion when this practice might not be followed. Further, in that case the criminal proceedings

were pending before the Magistrate's Court and there would have been some embarrassment to the accused in subjecting himself to a public

examination. Above all it will have to be observed that we are governed by Art. 20(3) of the Constitution of India and not by the practice in

London.

25. In *Raja Narayanlal Bansilal Vs. Maneck Phiroz Mistry and Another*, the Supreme Court, while considering the question whether an

examination of a person under the Indian Companies Act would offend the provisions of Art. 20(3) of the Constitution of India, held that Art.

20(3) of the Constitution of India had no application, as there was no accusation in the sense in which that expression had been construed. The

compulsion introduced by the provision of the Companies Act is not the compulsion which can be struck down by the provisions of the

Constitution.

26. In *Joseph Augusthi v. Narayanan* (1964) 1 Comp. L.J. 294 : (1964) 1 S.C.J. 676 : 34 Com. Cases 546 the Supreme Court construing S. 45-

G of the Banking Companies Act, 1949 held that the provision did not contravene Art. 20(3) of the Constitution of India. Referring to Art. 20(3)

of the Constitution of India, the Supreme Court observed that it is only when a person is said to have been accused of any offence that the

prohibition prescribed by Art. 20 (3) comes into operation and that if a person who is not accused of any offence is compelled to give evidence

and evidence taken from him under compulsion ultimately leads to an accusation against him, that would not be a case which would attract the

provisions of Art. 20 (3). Public examination under the provisions of the Companies Act would not amount to accusation and is not prohibited

under Art. 20 (3) of the Constitution of India. The submission that it may prejudice the first respondent in his criminal appeal will not entitle him to

the protection under Art. 20 (3) of the Constitution of India. In the result the application of the Official Liquidator is allowed so far as the 1st

respondent is concerned, and dismissed as regards others. The Official Liquidator

is authorised to engage a Counsel conduct the public examination of the 1st respondent and incur the necessary expenditure. The examination will be conducted by the Master. Report within six months. This order will be suspended for three weeks to enable the first respondent to file an appeal.