D. Doss and ors. Vs. C.P. Connell and W.A.P. Lobo (Joint Official Liquidators)

D. Doss and ors. Vs. C.P. Connell and W.A.P. Lobo (Joint Official Liquidators)

SooperKanoon Citation : sooperkanoon.com/795679

Court : Chennai

Decided On : Aug-12-1937

Reported in : AIR1938Mad124; (1937)2MLJ848

Appellant : D. Doss and ors.

Respondent : C.P. Connell and W.A.P. Lobo (Joint Official Liquidators)

Judgement :

Alfred Henry Lionel Leach, C.J.

1. This appeal and appeals Nos. 27 of 1937 and 28 of 1937 arise out of a misfeasance summons taken out by the Official Liquidators of the General Banking Corporation, Limited, against the directors of that company. The appeals have been heard together and it will be convenient to deal with them in one judgment.

2. The company was registered on the 11th May, 1933, for the purpose inter alia of doing all kinds of banking business. The promoter was one P.K. Nair, a barrister at law, who was at the time and has since remained an undischarged insolvent. Nair who was the ninth respondent in the proceedings Doss before the learned trial judge, arranged that he should be Connell appointed legal adviser to the company and the 'advisory and director'. A prospectus was prepared, but

fortunately there was no general application made to the public to subscribe Leach, C.J, shares. There were eight other directors, who were respondents 1 to 8. Two of them respondents 3 and 5 (B. Gulab-chand Sowcar and M.L. Ranganayakulu) were not served and they took no part in the proceedings. The fourth respondent, A. Madhava Rao, who was the Chairman of the company, and Nair, absconded before the proceedings commenced. The official liquidators sought to make all the respondents, except respondents 3 and 5, liable under Section 235 of the Indian Companies Act, 1913, for (1) a sum of Rs. 4,988-7-2 which has been misappropriated by Nair; and (2) a sum of Rs. 6,331-9-3 representing liabilities incurred by the company from the date it started business until the date of it closed its doors. The certificate permitting business to be started was issued on the 4th September, 1933, and business was actually commenced on the 7th of that month. The bank's doors were closed on the 16th February, 1934; a petition for winding up was presented on the 5th March of that year and on the 6th April, 1934, a compulsory winding up order was passed.

3. Mr. Justice Gentle before whom the case came held that respondents 1, 2 and 4 (Rao Bahadur M.C. Rajah, V. Venkateswara Sastrulu and A. Madhava Rao) were each liable to pay the sum of Rs. 4,988-7-2 claimed as the first item and respondents 2, 4 and 6 (the sixth respondent being D. Doss) were each responsible for the payment of the sum of Rs. 6,331-9-3 and the 2nd item claimed. He also held that in respect of the sum of Rs. 6,331-9-3, the first respondent was liable to pay Rs. 2,833-9-9, and the seventh respondent Rs. 5,408 these sums being calculated in accordance with the dates on which they resigned from the Board of directors. Appeal No. 26 is the appeal of the sixth respondent in respect of the sum of Rs. 6,331-9-3. Appeal No. 27 is by the seventh respondent in respect of the sum of Rs. 5,408; and appeal No. 28 embraces the appeals of the first and second respondents in respect of the sum of Rs. 41988-7-2, that of the first respondent in respect of the sum of Rs. 2,833-9-9 and that of the second respondent in respect of the sum of Rs. 6,331-9-3. The Doss fourth respondent has not appealed and the order of the learned has become final as against him.

4. The nominal capital of the company was Rs. 1,00,000 divided into 2,000 shares of Rs. 50 each. Of the Rs. 50 payable on each share, Rs. 10 was payable on

application, Rs. 15 on allotment and the balance in five equal instalments. The articles of association provided that the business of the company might be commenced as soon as 50 shares, that is, Rs. 2,500 had been subscribed. Before the company was incorporated a draft agreement had been prepared under which the company was to advance to Nair a sum of Rs. 10,000 on the security of his interests in the assets of the Indian Law Times, Limited, and a life policy of Rs. 10,000. The Indian Law Times, Limited, had been acquired by Nair and insolvency arose in connection with this business. The arrangement was that of the loan of Rs. 10,000, Rs. 5,000 should be paid to Nair for the purpose of enabling him to redeem the assets of the Indian Law Times, Limited, from the hands of the Official Assignee. After the incorporation of the company the agreement was executed and in due course Nair executed the requisite mortgage deed. Although business was not started until the 7th September, 1933, advertisements were inserted by Nair in the local press on the 21st June and 15th July, 1933, calling for applications for posts on the staff of the company. It was intimated that the successful candidates would be required to deposit security for the proper performance of their duties. Applications were received in the course of July and August, and a number of appointments was made, the persons appointed furnishing security in the aggregate sum of Rs. 10,720. I should mention that Article 63 of the articles of association provided that the chairman should have the power of appointing, promoting, reducing, suspending and removing all officers of the bank, subject to the approval of the Board of directors, and should have the power to fix all remunerations, salaries and wages to be paid by the company. Subscriptions were received for only 65 shares. The subscriptions by the respondents were as follows:

Respondent No. No. of shares.1 ... 52 ... 53 ... 204 ... 105 ... 56 ... 5 7 ... 58 ... 5

5. Respondents 1, 2, 4 and 6 paid nothing in respect of their shares. The third respondent paid Rs. 250 on account of the Rs. 1,000 owed by him in respect of his 20 shares, and the seventh respondent paid Rs. 20 on account of the Rs. 250 owed by him in respect of his five shares. Respondents 5 and 8 appear to have paid for their shares in full. The actual capital which the company had when it started business was Rs. 780.

6. The first item of the claim, namely, the sum of Rs. 4,988-7-2 represents security deposits provided by the employees which Nair put into his own pocket. The company had no right to utilise these monies for its own purposes and the fact that Nair misappropriated them is common ground. The learned Judge held that respondents 1, 2 and 4 were responsible for this sum, because they had not used reasonable care in carrying out their duties. He considered that it was incumbent on them to see that the company's moneys were in a proper state of investment and that Nair being an undischarged insolvent should not have been allowed to take charge of the security deposits of the employees. The learned Judge held as a fact that the second and fourth respondents had knowledge of Nair's insolvency, but he was not satisfied that the first respondent had such knowledge. He, however, held that they were all liable as they took no steps to see that a responsible person was attending to the company's finances. They had all failed to carry out their duties, and were guilty of the grossest negligence. The position with regard to this sum of Rs. 4,988-7-2 is altogether different from the position with regard to the sum of Rs. 6,331-9-3 which I will deal with separately.

7. With regard to the first sum, the learned Advocate for respondents 1 and 2 (appellants here) contends that the learned trial Judge has misconceived the law with regard to the duties of directors. He says that on the authorities it must be shown that the directors had knowledge of the facts and that they acted wilfully despite their knowledge. Before passing to the authorities I should refer to Article 95 of the articles of association. This article has been very badly drafted, but it is intended to comprise the usual indemnity to directors for anything done by them, except where loss has been incurred as the result of wilful neglect or wilful default on their part, and it is accepted by both sides, that it has this effect. The duties of directors and what is meant by wilful negligence were dealt with at length by Romer, J., in the case of City Equitable Fire Insurance Co., Ltd., In re (1925) 1 Ch. 407 . The learned Judge who discussed the authorities there pointed out. that in order to ascertain- the duties that a person appointed to the board of an established company undertakes to perform, it is necessary to consider not only the nature of the company's business, but also the manner in which the work of the company is in fact distributed between the directors and the other officials of the company, provided always that this distribution is a reasonable one in the

circumstances, and is not inconsistent with any express provisions of the articles of association. In discharging the duties of his position thus ascertained, a director must, of course, act honestly; and he must also exercise some degree of both skill and diligence. The learned Judge, however, pointed out that (1) a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience; (2) he is not bound to give continuous attention to the affairs of the company, his duties being of an intermittent nature to be performed at periodical meetings; and (3) in respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly. Dealing with the question of wilful negligence, the learned Judge observed (page 434 of the report):

An act, or an omission to do an act, is wilful where the person of whom we are speaking knows what he is doing and intends to do what he is doing-But if that act or omission amounts to a breach of his duty, and therefore to negligence, is the person guilty of wilful negligence? In my opinion that question must be answered in the negative unless he knows that he is committing, and intends to commit, a breach of his duty, or is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty.

8. This view was affirmed by the Court of Appeal consisting of Pollock, M.R., Warrington, L.J. and Sargant, L.J. With regard to the question whether a director is justified in trusting Doss the officials of the company, I would also refer to the observations of Lindley, M.R., in the case of National Bank of Wales, and Limited, In re (1899) 2 Ch. 629 :

Business cannot be carried on upon principles of distrust. Men in responsible positions must be trusted by those above them, as well as by those below them, until there is reason to distrust them. We agree that care and prudence do not involve distrust; but for a director acting honestly himself to be held legally liable for negligence, in trusting the officers under him not to conceal from him what they ought to report to him, appears to us to be laying too heavy a burden on honest

business men.'

9. This case was taken to the House of Lords (Dovey v. John Cory (1901) A.C. 477) Lord Davey there said:

I think the respondent was bound to give his attention to and exercise his judgment as a man of business on the matters which were brought before the board at the meetings which he attended, and it is not proved that he did not do so. But I think he was entitled to rely upon the judgment, information, and advice of the chairman and general manager, as to whose integrity, skill and competence he had no reason for suspicion. I agree with what was said by Sir George Jessel in Hallmark's case (1878) 9 Ch. D. 329 and by Chitty in In re Denham & Co. (1883) 25 Ch. D. 752 that directors are not bound to examine entries in the company's books. It was the duty of the general manager and (possibly) of the chairman to go carefully through the returns from the branches, and to bring before the board any matter requiring their consideration; but the respondent was not, in my opinion, guilty of negligence in not examining them for himself, notwithstanding that they were laid on the table of the board for reference.

10. Now what is the position here? As I have pointed out, the matter of the appointment of the staff was in the hands of the chairman. It is not suggested that respondents 1 and 2 had any reason whatsoever to suspect the integrity of the chairman. It is also not suggested, apart from his insolvency, that they had any reason to suspect the integrity of Nair. It is true that Nair was an undischarged insolvent, but insolvency does not necessarily mean that a man is a dishonest man. There is here an entire absence of anything which would point the finger of suspicion to either the chairman or to Nair in the matter of these appointments. There was certainly no reason for any of the directors to suspect that Nair would utilise the security deposits for his own purposes, and there is no reason to suspect that the chairman knew that he was so doing. It is abundantly clear from the minutes that when it was discovered that Nair had utilised these security deposits for his own purposes the matter was immediately taken up by the directors and he was called upon to repay. Nair appears to have utilised Rs. 4,500 of the deposits towards the Rs. 5,000 which was to be paid to him under the

mortgage for the purposes of redeeming the assets of the Indian Law Times, Limited, but instead of redeeming those assets he stuck to the money. But nobody knew about this until afterwards. The authorities show that where there is an indemnity clause of the kind we have here not only must a director be guilty of negligence, but he must know that he is committing a breach of duty or is recklessly careless in the matter. Romer, J., at page 468 of the report of the City Equitable Fire Insurance Company's case emphasised this. It seems to us that respondents 1 and 2 were justified in trusting the chairman and Nair to deal properly with the employees and therefore it cannot be said that they were guilty of wilful negligence in so doing. In these circumstances we consider that the appeal so far as it relates to the sum of Rs. 4,988-7-2 must be allowed.

11. But entirely different considerations arise with regard to the sum of Rs. 6,331-9-3. In this connection it is necessary to refer to Section 103 of the Indian Companies Act. This section provides that a company shall not commence any business or exercise any borrowing powers unless (a) shares held subject to the payment of the whole amount thereof in cash have been allotted to an amount not less in the whole than the minimum subscription; and (b) every director of the company has paid to the company on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, a proportion equal to the proportion payable on application and allotment on the shares offered for public subscription or, in the case of a company which does not issue a prospectus inviting the public to subscribe for its shares, on the shares payable in cash; and (c) there has been filed with the registrar a duly verified declaration by the secretary or one of the directors, in the prescribed form, that these conditions have been complied with. In this case the minimum subscription had been subscribed, but the amounts due on them by the directors had not all been paid and the certificate permitting the company to commence business had been obtained as the result of a false declaration made by Nair. The learned Judge found that all the respondents knew of the obtaining of this certificate and that they were fully aware of that the company had started business on the 7th September, 1933. They therefore all wilfully permitted the company to carry on business on the strength of a certificate obtained by a false declaration. We have no doubt that the respondents 2, 6 and 7 had knowledge of the obtaining of the certificate and of the

fact that business commenced on the 7th September, 1933. With regard to the first respondent it is said that he was actually in Madras only on the 26th, 27th and 28th of July, and between the 13th and 18th of August. But it is clear on his own evidence that he returned to Madras on the 28th September. We have no doubt that he was fully aware by that date, if not before, that the certificate had been obtained that business was being carried on. We are also satisfied that these four respondents were fully aware that the directors had not paid what was due in respect of their respective shares and that they knew that the company had no right to commence business. In any event they must be deemed to know the law. In Burton v. Bevan (1908) 2 Ch. 240 which was also a case of misfeasance Neville, J., remarked:

I think it is immaterial whether the director had knowledge of the law or not. I think he is bound to know what the law is, and the only question is, did he know the facts which made the act complained of a contravention of the statute?

12. In the present case the learned trial Judge has held that they did know and we are in entire agreement with him. This means that the directors allowed this company to open its doors and keep them open for months knowing full well that Section 103 had not been complied with, that the company had no capital with which to carry on business and that deposits made by customers in current and other accounts were being utilized by the management for the payment of wages and current expenses without any likelihood of the company being able to pay back such monies. In other words they knew that the bank was utilising its customer's monies dishonestly. As the result of the company having obtained by means of a false declaration a certificate allowing it to carry on business and as the result of the respondents having allowed the company to keep open its doors the company has suffered loss to the extent of Rs. 6,331-9-3. We are of opinion that respondents 2, 6 and 7 have been guilty of wilful negligence and they are liable to make repayment under Section 235 of the Indian Companies Act. We therefore agree with the finding of the learned trial Judge on the second part of the case.

13. We have been asked to relieve these respondents from the consequences of their wilful negligence, under the provisions Section 281 of the Indian Companies Act. That section provides that if in a proceeding for negligence, default, breach of duty or breach of trust it appears to the Court hearing the case that the person may be liable but has acted honestly and reasonably and ought fairly to be excused, the Court may relieve him wholly or in part from his liability. This power to relieve is placed in the hands of the Court when it is convinced that a person has acted honestly and reasonably. In this case even if it be said that these respondents acted honestly, it cannot be said that they acted reasonably and we are unable to grant them any relief under this section. The order of the learned Judge against the respondents 1, 2, 6 and 7 in respect of the second item of the claim will therefore stand. As the appellant have succeeded in part and failed in part, we do not propose to make any order as to costs. The liquidators will have their costs out of the assets of the company.