

In Re: M.K. Srinivasan

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Court : Chennai

Decided On : Feb-01-1943

Reported in : AIR1944Mad410

Appellant : In Re: M.K. Srinivasan

Judgement :

Happell, J.

1. The appellants, who will hereafter be referred to as accused 1 and 2 respectively, were promoters and two of the directors of a company designated 'The Sugar and General Investment Trust.' In connexion with the promotion and management of this company they were prosecuted in the Court of the Chief Presidency Magistrate for the offence of conspiracy to cheat the public by the issue of a prospectus punishable under Section 120B, Penal Code and for the offence of criminal breach of trust punishable under Section 409, Penal Code. Both the accused were convicted under the charge of conspiracy and for this offence were sentenced each to undergo one year's rigorous imprisonment. Accused 1 was also convicted under Section 409, Penal Code and for that offence he was sentenced to undergo 18 months rigorous imprisonment, the sentences in his case to run concurrently. To understand the case and the charges, it is necessary to refer to the events which preceded the formation of 'The Sugar and General Investment Trust' in 1936. There was in Travancore a company known as 'Travancore Sugars Limited' which operated a sugar factory at Thackalay in

Travancore State. This company was in fact controlled by the Travancore Government, which owned shares to the value of Rs. 2,50,000 out of a total share capital of Rs. 4,50,000 and had advanced a loan of Rs. 1,50,000 to the company on certain conditions. The company was not a success, and in 1933 for a few months a Mr. Crowther worked the factory on a contract basis. It was at this juncture that accused 2, N. S. T. Chari came on the scene. He purchased Mr. Crowther's interest and entered into an agreement with the company under which he was granted a lease of the factory, or what might perhaps be better described as a license to work it as a contractor, for a period of 15 years. 'Under the terms of the agreement he was himself to find working capital up to a maximum of Rs. 2 lakhs and was to receive a salary of Rs. 1000 a month and a percentage of profits, if any. The agreement contained two provisions which are of great importance in this case. Under the first provision accused 2 was prohibited from subletting or assigning his interest without the consent of the company, and under the second he himself assumed the liability to repay the loan advanced by the Travancore Government in annual instalments of Rs. 15,000 together with the interest on the loan. In the event of a breach of the first provision the agreement was to be ipso facto cancelled, and in case of a failure to comply with the second, the agreement provided that the company was at liberty to cancel the contract. The agreement between accused 2 and the company was executed on 1st June 1933. In 1934 accused 1 joined accused 2 and a fresh agreement was entered into between the company and them both, the second agreement being identical with the first except that for 'Chari,' was substituted throughout 'Chari and Srinivasan.' For a few months after the execution of the agreement with accused 2 the company made profits. But in the Malayalam year 1934-35 the factory worked neither continuously nor to capacity and between July 1935 and January 1936 it did not work at all. The reason for the disappointing results and the stoppage of work is said by the accused to have been the lack of raw materials. But the evidence of P.W. 20, the agent of the Travancore Government, indicates that inadequate finance was also an important factor. The two accused did not confine their activities to 'The Travancore Sugars.' There were three other enterprises with which they were concerned, a factory in Eramalikara, the Lakshmi Sugar Mills, and the South Indian Match Factory. At Eramalikara the accused purchased the machinery of a

sugarcane crushing factory and leased the land on which it stood for five years with an option to purchase within three years.

2. The primary object of this factory seems to have been to feed the Thuckalay Factory which was a sugar refining factory. The accused had leased the Lakshmi Sugar Mills for a period of nine years and were in negotiation with the South Indian Match Factory for acquiring the managing agency in respect of it. None of these factories was in a satisfactory condition at the beginning of 1936. The Thackalay factory had been closed for a considerable period in 1935 and had sustained trading losses. The Eramalikara factory had shown a loss of Rs. 2810 in 1934-35 and the Lakshmi Sugar Mills had shown trading losses of Rs. 6414 in 1933,-1934 and Rs. 33,209-15-7 in 1934-35. The South Indian Match Factory had sustained losses in each of the years 1933, 1934 and 1935. It was to acquire the rights and interests of the accused in the Travancore Sugars Ltd. and the other three concerns that the Sugar and General Investment Trust was formed. This company was incorporated on 23rd December 1935 and the prospectus was issued on 6th March 1936. The declaration of commencement of business was made on the same date. On 9th November 1936 a petition for winding up the company was presented, and on 23rd July 1937 an order directing that the company be wound up was passed. The first charge may now be considered. In substance it is that the accused conspired to cheat the public by the issue of the prospectus, Ex. D. In extenso, the charge is:

That you, M. K. Srinivasan and N. S. T. Chari were at Madras between November 1935 and October 1936, parties to a criminal conspiracy with the object of committing certain illegal acts, viz., cheating the public by making representations which you knew or had reason to believe to be false and by suppressing material facts in the promotion of the company and called the Sugar and General Investment Trust and thereby inducing the public to subscribe shares to the value of Rs. 98,525 and also to commit the offences of criminal breach of trust by an agent with regard to the funds of the said Sugar and General Investment Trust entrusted to you as managing agent of the company and thereby committed an offence punishable under Section 120B, Penal Code within the cognizance of this Court.' There can be no doubt, as the Chief Presidency Magistrate has said, that

the charge is not so precise as it might have been, and it is clear also that more particulars should have been given. The trial, however, of the case covered 51 days and it is not suggested that the accused did not understand the charge against them or that they were prejudiced in any way by its defects. In para. 7 of his judgment, however, the learned Chief Presidency Magistrate has observed that the Crown Prosecutor conceded that the conspiracy consisted in the publication of the prospectus and that no inference that the commission of breach of trust of the Trust funds was one of its objects could be drawn, and that he also conceded that so far as cheating is concerned, the offence consisted in suppressing material particulars from the prospectus and not in making false representations. The trial therefore proceeded on the assumption that the object of the conspiracy was to cheat the public and to induce them to subscribe share monies and further that the deception consisted in the dishonest concealment of facts. The concessions made by the learned Crown Prosecutor at the trial have been stressed by learned Counsel for the accused and he urges that it is not now open to the prosecution to maintain that the prospectus contains false representations, or to contend that acts of criminal breach of trust in respect of the company's funds after the company had been formed can be taken into account for the purpose of deciding the intention with which the prospectus was drawn and issued.

3. The object of the formation of the company is stated in the prospectus, as is usual in such documents, to be to do any kind of profitable business whatsoever. But the primary object, there can be no doubt, was to acquire and take over the rights and interests of the accused in respect of the Thackalay and Eramalikara factories. The substance of the prospectus is this: after reference to the objects and some other matters, there follow extracts from the Travancore Government's administration reports and speeches of the Financial Secretary relating to Travancore Sugars Ltd.; and then a review is made of the prospects of profits to be earned from the acquisition of the interests of the accused in the four concerns, Travancore Sugars Ltd., the factory at Eramalikara, the Lakshmi Sugar Mills and the South Indian Match factory. An estimate is made of the profits that can be expected from each of the concerns on the basis of raw materials available, output, prices and working expenses, and it is stated that in the case of Travancore Sugars Ltd., a profit of Rs. 94,653-5-4 per annum can be anticipated,

in the cases of Eramalikara Factory a profit of Rs. 55,000,. in the case of the Lakshmi Sugar Mills a profit of Rs. 56,250 and in the case of the South Indian Match Factory a profit of about Rs. 40,000. Nothing is said about the past history of these concerns or their financial position at the date of the incorporation of the company or the issue of the prospectus. Next, under the head ' Contracts ' a summary is given of the agreements which would be entered into by the company as provided by Article 3 of the Articles of Association. These agreements are:

(1) An agreement between the accused and the company whereby the company shall acquire and take over all such rights, privileges and interests of the accused in respect of the lease of the Travancore Sugars Ltd., as also the right of the accused embodied in the registered agreement dated 1st June 1933 between Travancore Sugars Ltd. and N. S. T. Chari, supplemented by the registered agreement of 12th December 1934 between Travancore Sugars Ltd. and N.S.T. Chari and M. K. Srinivasan already herein referred to and are capable of being lawfully assigned or transferred under Clause (v) of the principal agreement of 1st June 1933 aforesaid for the entire period of fifteen years extending upto 31st May 1948 and subject to the obligations and equities of the aforesaid agreement;

(2) an agreement whereby the company shall acquire the Eramalikara factory and the leasehold interest of the accused in respect of the land on which the factory is erected;

(3) an agreement whereby, unless the directors shall otherwise decide, the company shall take over the accused's interest in the Lakshmi Sugar Mills; and

(4) an agreement whereby the company shall have the option to take over the benefit offered. to the company by the accused of the managing agency of the South Indian Match Factory. The accused were to be paid for their interests in the Travancore Sugars Ltd. Rs. two lakhs and for their interests in Eramalikara factory Rs. 1 lakh by allotment of ordinary shares. They were also to be managing agents receiving an allowance of Rs. 1500 and were to be given 50 per cent. of the total amount of the profits in excess of the amount required for meeting the dividends due in respect of the preference share holders and a sum equivalent to six per cent. per annum on the paid up ordinary share capital. Drafts of the agreements to

be entered into by the company, and prints of the memorandum and articles of association, it was stated, might be inspected at the registered office of the company during office hours. The registered office of the company was in Madras.' The prosecution case is that there were three material omissions from this prospectus which rendered the impression given by it completely false and indeed the prospectus as a whole a sham. These omissions were alleged to be

(1) failure to reveal the true position of the concerns taken over by the Trust,

(2) failure to state explicitly that the contract entered into with the Travancore Sugars Ltd., would be cancelled by the subletting or assignment of their interests without the consent of that company, and

(3) failure to indicate that the contractors-the accused - were in arrears to the Travancore Government in respect of the annual instalments and interest payable by them so that for this reason also the contract could be cancelled. It will be convenient here to consider the law relating to the charge of conspiracy. Mr. Braddel contends that the Chief Presidency Magistrate has entirely misdirected himself, but he has not been able to show in what the misdirection consists. In para. 8 of his judgment the Chief Presidency Magistrate sets out the relevant provisions of the Penal Code and then considers some well-known English authorities. At the end of the paragraph he deduces certain principles. They are,

(1) that (in order to make a prospectus fraudulent it is not necessary that there should be false representation in it; even if every word is true, the suppression of material facts will render it fraudulent. To judge its effect, it should be read as a whole,

(2) it is not enough if the prospectus refers to the contracts and puts the intending shareholder upon enquiry as to their contents. Probably in

(1) it would have been more accurate to have said that the suppression of material facts 'may render it fraudulent' and in

(2) to have said that it is not 'necessarily' enough for the prospectus to refer to contracts and put the intending shareholders upon (enquiry. Otherwise, however,

there is no fault to be found with the principles deduced. Now the offence charged in the present case is that the accused were parties to a criminal conspiracy to cheat the public by omitting certain material facts from the prospectus and so inducing the public to buy the shares of the company. By definition under Section 415, Penal Code, a person cheats who, by deceiving any person, fraudulently or dishonestly induces the person so deceived to deliver any property to any person. The explanation to Section 415 states that a dishonest concealment of facts is a deception within the meaning of the section. The indictments in the two leading English cases with regard to criminal liability in respect of the publication of false prospectuses, *Rex v. Kylsant* (1932) 1 K.B. 442 and *Rex v. Bhishirgian* (1936) 1 All. E.R. 586 were laid under Section 84, Larceny Act. Under Section 84, Larceny Act, a director of a body corporate or public company is guilty of a misdemeanour if he makes, circulates or publishes any written statement or account which he shall know to be false in any material particular with intent to induce any person to entrust or advance property to the company. In *Rex v. Kylsant* (1932) 1 K.B. 442 Wright J., as he then was, had directed the jury that the language of Section 84, Larceny Act, was wide enough to cover a written statement that was false not in any specific facts or figures, but 'false because of what it does not state, because of what it implies.' The principal question for the Court of criminal appeal was whether the jury was misdirected and it was held that there had been no misdirection, but that the law had been correctly stated. In the case of a charge of conspiracy to cheat, apart from the ruling in *Rex v. Kylsant* (1932) 1 K. B. 442, there is not the same difficulty in view of the explanation to Section 415. There can be no doubt that in the case of a charge under the Penal Code if two or more persons agree to issue a document and by the concealment of facts to deceive the public and fraudulently or dishonestly induce them to deliver property, the offence of conspiracy to do or cause to be done an illegal act, namely, cheating, is completed. The essential ingredients are deception and an intention to defraud, and these must either be proved directly or inferred from the document itself and the surrounding circumstances. Where, as in this case and in most cases, the necessary intention has to be inferred from the nature of the document itself and the circumstances, the facts and circumstances must be such as to exclude any reasonable hypothesis of good faith. Mr. Braddel. has referred me to a number of

English authorities which are concerned mainly with the conditions that must be fulfilled in order that an action for misrepresentation may be maintained. Cases such as *Kent v. Freehold Land & Brickmaking Co.* (1867) 4 Eq. 588 and *New Somberero Phosphate Co. v. Erlanger* (1877) 5 Ch. D. 73 where it was held that shareholders were put on enquiry by a reference to the contracts and an invitation to inspect them, in my opinion, afford little guidance and must be regarded as decided on their own facts. It has been stated again and again in the clearest terms that where there is an intention to defraud it is no answer to the charge that the person defrauded could have escaped harm by taking more care. The authorities which in Avory J.'s opinion supported the view of the law taken by Wright J. are set out in the judgment of the Court of criminal appeals in (1932) 1 K. B. 4421 and it is not necessary to travel beyond them.

4. Lord Macnaghten said : *Gluckstien v. Barnes* (1900) A. C. 240, 'It is a trite observation that every document as against its author must be read in the sense which it was intended to convey. And everybody knows that sometimes half a truth is no better than a downright falsehood.' In *Peek v. Gurney* (1873) 6 H.L. 377, Lord Cairns said: 'Mere non-disclosure of material facts, however morally censurable, however that non-disclosure might be a ground in a proper proceeding at a proper time for setting aside an allotment or a purchase of shares, would in my opinion form no ground for an action in the nature of an action for misrepresentation. There must, in my opinion, be some active misstatement of fact, or at all events, such a partial and fragmentary statement of fact, as that the withholding of that which is not stated makes that which is stated absolutely false.' In *Aaron's Reefs Ltd. v. Twiss* 1896 A.C. 273, Lord Halsbury observed: 'I protest against being called on only to examine some specific allegation in it. I think one is entitled to look at the whole document and see what it means taken together.' Now what can fairly be said to be the impression which the prospectus was intended to make and would make on a member of the public who read it? It would be, I think, without doubt, at least that certain rights and interests which the vendors (the accused) had in Travancore Sugars Ltd. and the Eramalikara factory were to be transferred to the company and that there was a reasonable expectation that these rights and interests could be successfully exploited. If, however, a member of the public had gone to the office of the company, as he was invited to do, and inspected the

agreements he would have been considerably startled. He would have found the agreement, Ex. C-I, Clause (v) (the agreement between the accused and the Travancore Sugars Ltd., referred to in the prospectus) and would have seen that it provided that: 'No assignment or subletting if any by the contractor of his rights under this agreement shall be binding on the company unless the same be made with the previous consent in writing of the company, and it is distinctly agreed that the company shall be entitled in its absolute and sole discretion to refuse such consent without any reasons whatever being assigned for such refusal. In case any assignment or subletting is made by the contractor without the permission of the company as required above, this agreement shall ipso facto be void.'

5. If he went on then to ascertain how, in view of this clause, the agreement between the accused and the company had been drawn, he would have been still more startled to find that the agreement in fact did not assign or transfer the rights and interests of the accused to the company at all. He would have found that under Clauses (3) and (4) there was to be no assignment of the rights and interests of the accused under the agreement with Travancore Sugars Ltd., unless the Travancore Sugars Ltd., consented to the assignment; that the accused had not and apparently did not intend to apply for such consent; and that, in the meantime, all that the Investment Trust got out of their agreement with the accused was the liability on the part of the accused to carry on the contractorship in respect of Travancore Sugars Ltd., as the Agents of the Trust and to treat the profits and losses, etc., of the contractorship as the profits and losses of the Investment Trust. There was no privity of contract at all between the Investment Trust and Travancore Sugars Ltd., and the Sugars Ltd., were entitled, as they did do, to ignore the Investment Trust altogether. Next, if the member of the public had continued his examination of the agreement between the accused and Travancore Sugars Ltd., he would have found another provision, which is not mentioned in the agreement between the accused and the Investment Trust, and which is not referred to either expressly or by implication in the prospectus. A brief reference has already been made to this provision and it is to be found in Sub-clauses (o) and (s) of Clause (6) of the agreement between the accused and Travancore Sugars Ltd. It amounts to this, that the accused took over the liability of Sugars Ltd., to repay the loan made by the Travancore Government in annual instalments

of Rs. 15,000, together with the interest on the loan at six per cent. and that in case of failure to make the payments within the stipulated period the company had the right to put an end to the agreement.

6. The prosecution case is, therefore, that the accused could not have omitted to state in the prospectus matters so vital as (1) that the agreement between the accused and Travancore Sugars Ltd., was ipso facto cancelled if the accused assigned their interests under the agreement without the consent of the company, and that consequently the interests of the accused could not be and were not assigned under the agreement between the accused and the Investment Trust, and (2) that the agreement between the accused and the Travancore Sugars Ltd., was liable to be cancelled for failure to make certain payments in respect of which the accused were in default at the date on which the prospectus was issued, otherwise than deliberately, and with the intention of deceiving the public and so inducing them to invest in the Investment Trust Company. It is argued by Mr. Braddel for accused 1 that the agreement between the accused and the Investment Trust does not amount to a transfer or assignment of the accused's rights and interests so that the agreement between the accused and Sugars Ltd., was not cancelled by virtue of this agreement. This, I think, is true, but it does not help the accused. Either there was an assignment of the accused's rights and interests, and that is the impression which, in my opinion, the prospectus gives, in which case the agreement with Sugars Ltd., became ipso facto cancelled, or, there was no assignment, which is the effect of the agreement (Ex. C-I) but not of the prospectus, in which case the Investment Trust has not been given that which was the principal object of the formation of the company. It is argued further that the prospectus does make a sufficient disclosure of the position with regard to the assignment of the rights and interests of the accused under the agreement between them and the Travancore Sugars Ltd., and their position vis a vis the Sugars Ltd., in view of the use of the words 'such interests as are capable of being lawfully assigned,' the specific reference to Clause (v) of the principal agreement of 1st June 1933, and the invitation to inspect. But why should reference to the facts be made in this oblique way? Why could it not be plainly stated, it would have taken no longer, that there could be no assignment without the consent of Travancore Sugars Ltd., that their consent had not been obtained, and that

consequently the agreement between the accused and the Investment Trust did not provide in presenti for the assignment of the accused's rights and interests under the other agreement. The observation of Lord Macnaghten in 1900 A. C. 24Q5 that 'Everybody knows that sometimes half a truth is no better than a downright falsehood' would seem relevant to the presentation in the prospectus of this matter of the assignment of the accused's rights and interests to the Investment Trust; and the observation of Lord Halsbury in 1896 A. C. 2737 is also relevant, namely, that what matters is 'Was there false representation? I do not care by what means it is conveyed, by what taint or device or ambiguous language; all these are expedients by which fraudulent people seem to think they can escape from the real substance of the transaction.'

7. I am quite unable to accept the contention that what the Trust did get was as beneficial to it as the assignment of the rights and interests of the accused under the agreement. It is not conceivable that a member of the public would have invested in the Investment Trusts Ltd., if he had known that the company was not to obtain the rights and interests of the accused under the agreement with Travancore Sugars Ltd., and if he had known that there could be no privity of contract between the Investment Trust and the Travancore Sugars Ltd. It is true that, apart from the acquisition of the rights and interests of the accused in the Travancore Sugars Ltd., three other specific objects of the formation of the Trust are mentioned, namely, the acquisition of the rights and interests of the accused in the Eramalikara factory, the Lakshmi Mills and the South Indian Match factory. There can, however, be no doubt that, as Gentle J. put it in his winding up order, the substantial substratum of the company was the interests of the accused in the lease of the Thackalay factory obtained through the agreement with Travancore Sugars Ltd., and that the principal object of the incorporation of the company was the acquisition of these interests. The Eramalikara factory was worked in connection with the Thackalay factory and was intended to feed it; and in the case of the other two companies, the Investment Trust Company had only acquired options to acquire the interests of the accused. It may, however, be mentioned that in so far as a prospective investor was influenced to any degree to invest his money in the Trust by the fact that the company had acquired an option to take over the accused's interests in the South Indian Match Factory, he was misled.

The accused had no interests in the South Indian Match Factory to transfer. They were merely in negotiation with the directors of the factory.

8. That the failure to disclose in the prospectus the provision relating to the cancellation of the contract in the event of failure to pay the instalments, and interest, and that the accused were in arrears with these payments were not purely academic questions would seem to be proved by the fact that three months after the company commenced business, the agreement was cancelled by the Travancore Sugars Ltd., on the ground that default had been made in the payments. The argument advanced on behalf of the accused is that there was no necessity for disclosure for the reason that the accused were in command of the necessary funds and that they could not know that Travancore Sugars Ltd., would wrongfully refuse to receive payment when it was proffered. This point will be more conveniently dealt with after a complete picture of all the circumstances has been obtained, and I propose to return to it when the charge against accused 1 in respect of criminal breach of trust has been considered. I pass now to a consideration of the charge of criminal breach of trust against accused 1. This charge covers a sum of Rs. 17,271-14-6 which is made up of items which are detailed under the separate heads of charge 1 to 8 in charge II. (After elaborately discussing the evidence his Lordship proceeded.) I return now to the prospectus in order that it may be considered in the light of all the circumstances. In other circumstances the failure to disclose the financial position of the various concerns which the company was to take over might not be taken to prove that the prospectus was intended to give a false impression. But the circumstances as a whole must be looked at. The accused did not disclose that they had no interest in the agreement with Travancore Sugars Ltd., which they could assign, they did not disclose that they were in arrears with payments which rendered the agreement liable to cancellation; and when the prospectus was issued they were in a desperate financial condition. None of the concerns with which they were connected were profitable; they owed a large sum of money to Mr. Bhide and they owed large sums to the Quilon Bank which had stopped their credit. I have already given it as my opinion that the reference to the assignment of the interest in the agreement with Travancore Sugars Ltd., is on the face of the prospectus itself a half truth intended to deceive and no better than a downright falsehood. In the light

of the circumstances, in my judgment, the failure to disclose that the accused were in arrears with their payments and that the agreement might be cancelled for that reason was also intended to deceive and a deliberate suppression of material facts. The subsequent dealings with the funds of the company excludes any reasonable hypothesis of good faith. The funds were not utilised for the purpose of the company but to enable the accused to clear themselves of the consequences of the unsuccessful enterprises with which they had been connected in Travancore since 1933. In my opinion, both accused have been rightly convicted of an offence under Section 120B, Penal Code, and accused 1 has been rightly convicted of the offence under Section 409 of the Code. The sentences cannot be said to be unduly severe.

9. Accused 2 was separately represented and it was argued for him that he was merely an industrial chemist, that accused 1 attended to the business side of the enterprise, and that in his case no intention to deceive and defraud by the issue of the prospectus was proved or can be presumed. The prospectus, however, was fraudulent and accused 2 was a party to it. It was he who first executed the agreement with the Travancore Sugars Ltd., and it was on his initiative that a first draft of the clause relating to the prohibition against assignment was modified. He has been connected with business enterprise all his life, and there is no evidence that he was a scientist pure and simple, who left all business matters to accused 1. I am not therefore able to accept the contention advanced on his behalf. The learned Chief Presidency Magistrate has written a careful and exhaustive judgment, and no successful criticism of it has been made. I have, however, only made occasional reference to the judgment for the reason that the whole case, which depends mainly on documentary evidence, has been before me, and that he himself only saw a few of the important witnesses. The appeals are dismissed. The direction made by the Chief Presidency Magistrate with regard to the class in which the prisoners are provisionally placed appears to be in accordance with the rules.