

(1976) 12 GUJ CK 0012

Gujarat High Court

Case No: None

In Re: Bhavnagar Vegetable
Products Ltd.

APPELLANT

Vs

RESPONDENT

Date of Decision: Dec. 24, 1976

Acts Referred:

- Companies Act, 1956 - Section 215, 215

Citation: (1977) 47 CompCas 775 : (1977) 18 GLR 889

Hon'ble Judges: D.A. Desai, J

Bench: Single Bench

Judgement

D.A. Desai, J.

This summons is taken out by the Liquidator of Bhavnagar Vegetable Products Limited (in liquidation), requesting the Court to direct the Directors of the company to sign and authenticate the audited balance sheet and profit and loss account as required by Section 215 of the Companies Act and to give necessary authentication of certificates of basic data and particulars entered into accounts and also the information and explanation as required in the draft report and the letter dated 29th November 1976 of the auditors. Further direction sought was that Tungbahdra Industries Limited (sponsor for short) and Dena Bank, United Commercial Bank, State Bank of Saurashtra, Indian Overseas Bank and Bank of Baroda be directed to get the stocks of the company physically verified, inspected and valued by M/s. General Superintendence Company (India) Private Limited and/or their representatives.

2. The company was ordered to be wound up by an order made by this Court on 15th September 1976. In an appeal preferred against the order winding up the company, stay of operation of the order was granted but I was informed that the stay is vacated. Therefore, at present, there is no stay of the winding up order. This Court made an order on 7th May 1976 directing the liquidator to appoint auditors to

audit the books of account of the company so as to be able to arrive at a reasonably clear picture of the state of affairs of the company. In order to satisfy the requirements of the proviso to Section 391(2), it was necessary to have the latest balance sheet and profit and loss account of the company and therefore, the direction was given that M/s. Kantilal Patel and Company, Chartered Accountants be appointed to audit the books and submit a report showing the position of the company as on 31st December 1975. The auditors have prepared a draft report and in the course of auditing, they came across certain things for which they want the explanation of the Directors who are liable to render the same and are not offering explanation. By a letter dated 29th November 1976 annexure "A" to the affidavit in support of the summons the auditors requested the liquidator that steps should be taken for authentication of the statement of account prepared by them by the Directors and Secretary of the company as well as authentication of the certificates of the basic data and particulars entered into the accounts. The draft also sought certain information, which the auditors requested the liquidator to furnish. Thereafter, the liquidator took out the present summons. It has been served upon the Directors, the petitioning-creditor, the sponsor of the scheme and various banks who claim to be the creditors of the company.

3. Mr. A.H. Mehta, learned Advocate who appeared for Director No. 5-Indrajit Jamnadas Thakkar, No. 14 Navinchandra Gaurishanker Vyas and No. 16-Nissarhuscin Abdulhusain Merchant, led on behalf of the objecting Directors and most of his arguments were adopted by others who raised objection to the summons being granted. It is, therefore, necessary to dispose of the objections raised by Mr. Mehta.

4. In respect of the first direction, Mr. Mehta contended that this Court has no jurisdiction under Sections 215 and 217 to call upon the Directors to sign and authenticate the audited balance sheet and profit and loss account nor even the Court has power to direct the Directors to appear before the auditors and submit explanation sought by the auditors. In short the objection was that Section 215 does not confer any power on the Court to give such direction.

5. For the purpose of the present direction, it was assumed that those who object to the summons were the Directors of the company because it is in their capacity as Directors that they are being called upon to do various things by the liquidator. The question that would then arise is whether those who are Directors can be called upon by the Court to do various things as prayed for by the liquidator in the summons. This would necessarily require examining the duties of the Director. It is now indisputable that Directors stand in a fiduciary position with the company. Apart from various statutory liabilities, which they undertake on becoming Directors, this is the position, which is beyond controversy that Directors stand in fiduciary position in relation to the company. This is a position of utmost trust. Professor Gower in his Principles of Modern Company Law 3rd Edition, after

referring to the article styled "Fiduciary relationship" and "the Director as Trustee", has observed that the correct position of a director has been settled by Romer, J. when he said that the Directors are agents of the company and are in fiduciary relationship to their principal company. The duties of good faith which this fiduciary relationship imposes are virtually identical with those imposed on trustees and to this extent, the description "trustee" still has validity. It is this duty of a director which must be kept in view before deciding whether they can be asked to do what Liquidator wants them to do.

6. However, at the inception, it would be necessary to refer to some of the statutory provisions with respect to the duty of the directors. Section 209 provides that every company shall keep proper books of account with respect to various things mentioned in that section. Section 209A requires the books of account, other books and papers of the company to be kept open for inspection during business hours by the Registrar of companies or by such officer of the Government as may be authorised by the Central Government in this behalf. Section 210(1) imposes an obligation on the Board of Directors of the company to lay a balance sheet as at the end of the period specified in this behalf and profit and loss account for that period before every general meeting of the company held in pursuance of Section 166. On a combined reading of these sections, it is crystal clear that the company must maintain books of account; that the books of account are open for inspection by the Registrar without any previous intimation and that at the end of the financial year, the balance sheet and profit and loss account is to be prepared and it is to be laid before the general meeting. The duty is cast on the Board of Directors. In order to discharge the last duty, viz. getting prepared the statements of account, balance sheet and" profit and loss account, it will be the duty of the Directors to see that regular books of account of the company are kept. That would again be the duty of the Board of Directors. If they are required to maintain books of account, it would be their duty to see that correct and regular books of account are kept. They should exercise such care and skill and such degree of supervision as would enable them to see that provisions of Section 209 onwards are faithfully and effectively carried out. If the directors neglect to provide for maintenance of books of account for the whole year, I fail to see how at the end of the year, they would be able to carry out the obligations and duties imposed on them by Section 210(1). Balance sheet and profit and loss account can be prepared or compiled on the basis of the accounts maintained during the year. It is no argument that only if a general meeting is to be convened and at such general meeting, a statement has to be produced that accounts are required to be maintained and as there is no question of calling the general meeting because the company is ordered to be wound up and therefore Section 210 does not come into play. How can one look forward to the end situation that just before the time general meeting is to be convened, the company would be wound up and therefore Directors were free from the liability of keeping accounts. It is therefore, indisputable that the Board of Directors has to make necessary

arrangement for maintaining and keeping regular books of account which should be available for inspection and which should be according to the prescribed standard and on the basis of which balance sheet and profit and loss account will be prepared by the Board of Directors.

7. Now Section 224 imposes a duty on the company to appoint at each annual general meeting, auditor or auditors to hold office from the conclusion of the meeting until the conclusion of the next annual general meeting. Duty to appoint auditors is thus statutory. Section 226 prescribes qualifications of auditors. Then comes Section 227 which is material. It provides that every such auditor of the company shall have a right to access at all time, to the books and accounts and vouchers of the company whether kept at the head office or elsewhere and shall be entitled to require from the officers of the company such information and explanations as the auditor may think necessary for the performance of his duties as auditor. An auditor thus enjoys a statutory right to call for explanations from officers. Expression "Officer" is defined in Section 2(3) to include any director, managing agent, secretaries and treasures etc. Now, if I remove the word "officer" from Section 227 and read the word "directors", the section will read "the auditor shall be entitled to require from the directors of the company such information and explanations as the auditor may think necessary for the performance of his duty as auditor." It thus becomes a statutory duty of the director to keep the accounts or arrange to maintain the accounts of the company, to prepare balance sheet and profit and loss account and before it can be so done, to offer explanations and information called by the auditors.

8. Mr. Mehta does not dispute this position but his contention was that this obligation is imposed upon the directors of a company which is functioning and if the company is ordered to be wound up and the liquidator steps in, the directors cease to enjoy the status of Directors and hence could not be asked to discharge a function which they were bound to discharge if they continued to be Directors. If that were to be so, it would only mean that the provisions onwards from Section 433 of the Companies Act would be rendered totally nugatory. Once a winding up order is made, the Board disappears. But the obligations and liabilities incurred during the period the company functioned are not discharged on the making of winding up order. If accounts are kept for a financial year and they are examined either by the auditor appointed at the general meeting or appointed by the Court but the accounts relate to the period when Board of Directors was in charge of the company, then notwithstanding the winding up order, Directors are liable to render explanation. Mr. Mehta's argument comes to this that if the accounts are being audited by the auditors for the period for which there were some Directors, the duty of the Directors u/s 227 came to an end as soon as winding up order is made. If this company was functioning and there was no winding up order, u/s 227 the auditors would have a right to call upon the Directors to submit explanation. If a winding up order intervenes the position in law in this behalf does not undergo

change. Directors may cease to enjoy power, but obligations and liabilities incurred during the period they were Directors do not evaporate with the passing of the winding up order. In fact they can be enforced at the hands of the liquidator. This is the scheme of the winding up provisions of the Companies Act.

9. Mr. Mehta had an extreme argument to offer in this connection. He said that if Directors had committed any offence, they should be prosecuted but the liquidator cannot call them to offer explanation. I have not been able to fully grasp the meaning of this submission. I would prosecute. There would be no hesitation in doing so. But that does not put an end to the liability to give explanation. The argument is that if called upon to explain, they would squarely be bound by the explanation which may hamper their defence in the prosecution that may be launched against them. That was Mr. Mehta's passing apprehension. But the argument which in terms was posed is that the various provisions herein discussed do not confer any power on the Court to call upon the Directors to explain something which happened during the period they were Directors because the auditors appointed by the Court and not one appointed by general meeting seeks their explanation. Fact situation is slightly different though I do not propose to rest this order on that position. Auditors appointed by the general meeting disclosed their disinclination to audit accounts. Therefore, the Court appointed the auditor. But the irrefragable and important fact is that auditor has audited accounts for the period when there was a Board of Directors. And Directors of such Board are being called upon to render explanation for the period they were in office. Accounts are required to be maintained statutorily. The duty to explain arises, under the statute. Vacation of the office of director does not ipso facto bring an end to the liability to offer explanation, which was statutorily placed there u/s 227. Therefore, there is no substance in the contention of Mr. Mehta that the Court cannot call upon the Directors to appear before the Chartered Accountants and auditors appointed by the Court to submit explanations on the questions and queries raised by them.

10. There is one apprehension of Mr. Mehta against which I would like to guard. He said that direction sought is a composite direction. He is right. He says that by composite direction, the Directors are called upon to appear before the auditors, give explanations, sign the accounts and authenticate the certificates. He says that after offering explanations, the auditors may prepare same accounts and/or other accounts and the Directors cannot be asked to sign the same. At present, I propose to confine myself to one part of the prayer viz, to appear before the auditors and to submit explanations. Authentication will come at later stage. Under this guise, the Directors cannot be allowed to escape. Therefore, I confine my attention in this summons, to that part of prayer by which the Directors are called upon to give explanations in respect of queries and points raised by the auditors in their draft report submitted by them to the liquidator. To that, there cannot be such objection viz. that the director is being called upon to be a party to a document to which he does not subscribe. If there is statutory liability to sign, I will examine it later on. For

the present, I will grant a part of the prayer in the summons.

11. Mr. A.L. Shah, learned Advocate on behalf of Director No. 3 -Ahmedhusen Abdulhusen Merchant urged that A A. Merchant resigned from the office of director with effect from 1st October 1974. Mr. K.A. Mehta on behalf of director No. 7 - Mohmedhusein Abdulhusen Merchant stated that he resigned in June 1975. Mr. D.U. Shah, learned Advocate for director No. 6- Mohmedhusein Noormohmed Merchant and No. 8 Fidahusen Noor-mohmed Merchant, urged that they were minority Directors since 1971 and they did not participate in the management of the office and resigned from the office of director on 4th October 1974. Their resignations were accepted on 30th April 1975. Miss S.M. Madan, learned Advocate on behalf of director No. 10 Sultanali Kasamali Ladiwala urged that the director S.K. Ladiwala resigned from the office of the Director on 9th December 1975. All these advocates invited me to hold that they are not liable to give any explanation as sought by the auditors.

12. In order to dispose of this summons, it is necessary to state that the relevant period for which accounts are prepared commences from 1st November 1974 and ends on 31st December 1975. If any one who was a director during this relevant period, he must give explanation. If he is a minority director and did not participate in the management, that would be his answer. Resignation of a director becomes effective from the day on which it is accepted. If any other construction is to be accepted, the result would be that all of them can walk out on the day preceding the date on which the accounting year comes to close and on the last day they would pocket balance in their hands and nothing can be done to them, because they cannot be asked to explain. The period for which the accounts are compiled, would ipso facto determine the liability of the director to explain things arising from the accounts for the period and would fasten upon those persons who during the period, for long or for short, for a day or for month, were Directors. Mr. D.U. Shah pointed out that director Nos. 6 and 8 were minority Directors since 1971 and they were not participating in the management. It may be true. But it cannot dispose of the liability if till April 1975 viz. the date of resignation, the public register of the company showed them as Directors. It is true that they may give an explanation that as they were not participating in the management, they cannot offer any explanation. If this statement is correct, the answer is to be accepted. But can it be an argument that because during a part of the period for which accounts are compiled, a person walked out from the office of the director, his liability to explain statutorily cast u/s 227(1) would be discharged or he would be freed from the liability? It cannot be so. Therefore, all these gentlemen who said that they have resigned but appear to have been on the public register of this company as directors for some period of time out of the period for which the accounts are compiled by the auditors and explanations are sought, they would be liable to answer. Mr. G.N. Shah, learned Advocate for Directors No. 2-Dhirajlal Babubhai Sanghvi, No. 4-Kiritkumar Ratilal Gandhi and No. 9 Nagardas Ranchhoddas Sanghvi,

stated that keeping open all the contentions, they agree to appear before the chartered accountants to offer whatever explanation they can offer after taking inspection of the books if they want to take and then submit statement of concurrence in respect of statement of affairs filed by the other Directors. There is no other contention on his behalf.

13. Accordingly, this summons is granted in respect of prayer (a) to the effect that the Directors shown at Serial Nos. 2 to 16 should appear before the chartered accountants within a period of three weeks from today according to the date appointed by the chartered accountants and to offer explanations in respect of queries raised by the chartered accountants in the draft report submitted by them to the liquidator in respect of the accounts of the company for the period 1-11-1974 to 31-12-1975.

14. Summons is also granted 7 in terms of prayer (b) that all of them are called upon to submit in writing their acceptance of the inventory of the stock and goods made by M/s. General Superintendence Company (India) Private Limited for and on behalf of Dena Bank and UC Bank. M/s. General Superintendence Company is appointed to verify and finally check and prepare the inventory of the stock with the State Bank of Saurashtra and any other stock with the company, and the cost of verification of the stock with the State Bank of Saurashtra shall be borne by the State Bank of Saurashtra. The cost of verification and preparation of the inventory of the stock with the company other than those on which claim is laid by Dena Bank, UC Bank and State Bank of Saurashtra should be borne by the sponsor of the scheme viz. Tungbhadra Industries Limited and they must deposit through petitioner Velji Shamji and Company Rs. 1200/- with the liquidator within ten days from today. If the Directors so desire, they or their nominees may remain present when verification is undertaken by M/s. General Superintendence Company but if they failed to avail of this opportunity, their subsequent objections would be disregarded. No order as to costs of this summons.