REPORTED

*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **RFA 14/2010 and CM No.495/2010**

MUKESH HANS & ANR. ..... Appellants
Through: Mr. Ashim Vachher and Mr. Wasim Hashmi, Advocates

versus

SMT. UMA BHASIN & ORS. ..... Respondents
Through: Mr. Ujjwal Jha, Mr. Puneet Parihar and Ms. Aradhana Kumari, Advocates

% DATE OF DECISION : AUGUST 16, 2010

CORAM:
HON'BLE MS. JUSTICE REVA KHETRAPAL

1. Whether reporters of local papers may be allowed to see the judgment?

2. To be referred to the Reporter or not?

3. Whether judgment should be reported in Digest?

: REVA KHETRAPAL, J.

1. This appeal is directed against the judgment and decree dated 18.09.2009 passed by the learned Additional District Judge, Delhi in a suit under Order XXXVII of the Civil Procedure Code.

2. The appellants were the erstwhile Directors of the Company, M/s. Dawson Leasing Limited arrayed as defendant No.1 in the suit, which was a company duly incorporated and registered under the Companies Act, 1956 having its registered office at B-152, East of Kailash, New Delhi. The case of the respondents as set out in the plaint is that the

appellants had approached and lured them to invest a sum of Rs.10,01,142/- in secured non-convertible debentures of the said Company, namely, M/s. Dawson Leasing Limited for a period of 17 months. The appellants had also issued certain cheques to the respondents totalling Rs.9,30,00/-, the details whereof are set out in paragraph 6 of the plaint. On presentation, all the aforesaid cheques were returned dishonoured with the remark "PAYMENT STOPPED BY DRAWER", except for one cheque which was dishonoured due to "ACCOUNT SEIZED". It is further alleged in the plaint that the respondents subsequently came to know that the aforesaid Company had issued the non-convertible debentures in contravention of the Companies Act, 1956 without creating any charge against them, which is a pre-condition for the issuance of non-convertible debentures. Accordingly, on 16.04.1999, 19.04.1999 and 19.04.1999, the respondents-plaintiffs submitted their debenture certificates with the office of the Company with a request for premature redemption, but the said request was declined by the appellants, who refused to encash the same. On subsequent enquiry, it came to the knowledge of the respondents-plaintiffs that the said certificates were also not signed by the authorized signatory. The respondents sent a legal notice dated 19.04.1999 under Sections 138 and 141 of the Negotiable Instruments Act read with Sections 406, 420 IPC in respect of the dishonoured cheques, but no payment was made by the appellants. It is alleged that the appellants thus jointly and severally and with malafide intention "deceitfully

defrauded" the respondents of a sum of Rs.10,01,142/- by inducing them to invest in secured non-convertible debentures and thereafter illegally retaining the amount of the said debentures.

3. Summons for judgment were served on M/s.Dawson Leasing Ltd. (the defendant No.1) and the appellants (the defendants No.2 and 3 in the suit), whereupon an application for leave to defend was filed by them on 25.07.2000, that is, within stipulated period of time, praying for unconditional leave to defend the suit. It was, inter alia, submitted in the said application that the present suit was not maintainable under the provisions of Order XXXVII nor the appellants were liable to make the payment to the respondents. The liability, if any, was that of the public limited company (M/s.Dawson Leasing Ltd.) which had invited subscription to the secured non-convertible debentures. There was no contract of guarantee, privity of contract or even an assertion in the plaint that the appellants had undertaken to make payment to the respondents of the loan amount on behalf of the Company. There was no joint or several liability and the liability, if any, was the sole liability of the Company. In the affidavits supporting the application for leave to defend, the appellants categorically stated that the suit filed by the respondents ought to be tried as an ordinary suit for the reason that a bare perusal of the plaint would show that the suit could not be tried and adjudicated except by recording detailed evidence. It was further stated on affidavit that the respondent No.4 (the plaintiff No.4 in the suit) and his brother were Directors of the Company, M/s.Dawson Leasing

Limited and the decision to invite secured non-convertible debentures was taken by none other than the Board of Directors of the Company, including the respondent No.4 and his brother. The latter were in fact working as functional Directors of the Company, looking after the day-to-day affairs of the Company. The requisite formalities required to issue the debentures in question were undertaken by the respondent No.4 and his brother and their names also appeared in the offer document issued on behalf of the aforesaid Company. Thus, it was not open to the respondents to allege that they had been deceived and defrauded. Further, none of the other Directors of the Company arrayed as appellants in the suit were responsible for the discharge of the liabilities of the Company, which had suffered losses due to bad debts and severe recessionary conditions. The debentures, it was asserted, were issued by the Company in accordance with all the rules and regulations. Merely because after the subscription of the debentures the respondent No.4 had resigned as Director due to business reasons, he could not shake off the responsibility of having decided with the other Directors to issue debentures on the terms and conditions as contained in the offer document.

4. The respondents filed reply to the application under Order XXXVII Rule 3, contending that no triable issue had been raised by the appellants and hence the application for leave to defend was liable to be dismissed. Significantly, in the said application, there was no denial of the assertion made by the appellants that the respondent No.4 and his

brother were the Directors of the defendant No.1 Company and privy to the decision to invite secured non-convertible debentures. There was also no denial of the assertion made by the appellants herein that the requisite formalities required to issue the debentures in question had been undertaken by the respondent No.4 and his brother and their names had also appeared in the offer document issued on behalf of the Company. Further, the respondents nowhere denied the statement made on oath by the appellants that there was no contract of guarantee or undertaking from the side of the appellants to make payment to the respondents of the loan amount on behalf of the Company and that the liability, if any, was the sole liability of the Company.

5. The learned trial Judge after hearing arguments on the application seeking leave to defend rendered the following findings:-

> *"The company issued the debentures certificates to the plaintiff. The defendants have also issued certain cheques which were got dishonoured due to "ACCOUNT SEIZED". The defendant company had issued Non-convertible debentures in the contravention of the Companies Act, 1956 violating various provisions of the Act and with a malign motive of committing fraud (sic.) and cheating the investors. Hence they are liable to pay this amount alongwith interest. The amount was invested in the debentures. As such there is no triable issue raised in the application seeking leave to defend. Hence application seeking leave to defend is dismissed.*
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> *Suit of the plaintiff is decreed for a sum of Rs.10,01,142/- alongwith interest pendente lite and future @ 12% PA. Decree sheet be prepared. File be consigned to Record Room."*

6. The learned counsel for the appellants, Mr. Ashim Vachher has assailed the aforesaid findings of the learned trial court on the ground

that the appellants were not liable to make the payment to the respondents as admittedly there was no contract of personal guarantee nor there was any privity of contract between the appellants and the respondents. The learned counsel for the appellants pointed out that in the entire plaint it has nowhere been alleged that there was any personal guarantee executed by the appellants in favour of the respondents or that there was any privity of contract between the respondents and the appellants herein at the time of subscribing to the secured non-convertible debentures by the respondents. According to the learned counsel for the appellants, the learned trial court failed to appreciate that it is a well settled principle of law that a Director in a Company, being a public limited company or a private limited company, does not have any personal liability towards any of the creditors of the Company. Admittedly, the appellants were merely the Directors of the Company, M/s.Dawson Leasing Limited and had neither executed any personal guarantee nor any security document in favour of the respondents. Hence, the appellants could not have been held personally liable and the impugned judgment and decree were liable to be set aside on this ground alone.

7. Mr.Vachher the learned counsel for the appellant emphasized that decision to issue the secured non-convertible debentures was taken by none other than the respondent No.4 and his brother, namely, Mr.Kapil Bhasin, who were working as full-time functional Directors and were responsible for the day-to-day affairs of the Company M/s.Dawson

Leasing Limited. Thus, the respondents' allegation that they had been deceived or defrauded by the appellants or any other person is on the face of it devoid of substance. Finally, it was contended that the learned trial court has nowhere held as to how the appellants were personally liable to pay the alleged outstanding dues of Rs.10,01,142/- along with the accrued interest thereon. In fact, it is nowhere stated by the trial court that the appellants are "jointly and severally" liable to pay the alleged outstanding dues of the said Company which had issued the non-convertible debentures.

8. The learned counsel for the respondents sought to counter the aforesaid contentions of the appellants' counsel by contending that the issuance of debentures and thereafter the issuance of cheques by the appellant No.2 which were subsequently dishonoured, is sufficient to show that the appellants had issued the debentures with the intention of committing fraud and cheating the investors. Hence, they are liable to pay the amount invested by the respondents.

9. At this juncture, it may be noted that during the pendency of the suit, the Company, M/s. Dawson Leasing Limited has gone into liquidation as a result of a winding up petition filed in this Court. By an order dated 9th November, 2000 passed by this Court, the official liquidator was directed to take over the assets of the said Company. The respondents thereupon filed an application under Section 446 of the Companies Act, 1956 seeking leave to continue with the proceedings in the suit and were granted the same, but subject to the condition that the

execution could be initiated only with the permission of the Company Court.

10. The short question which arises for consideration in the present appeal is as to whether the appellants as erstwhile Directors of the Company, M/s. Dawson Leasing Limited (In Liquidation) can be made liable in a suit for recovery of money when the Directors have not made themselves personally liable by extending any guarantee, indemnity, etc.

11. Indubitably, a company incorporated under the Companies Act, whether as a private limited company or a public limited company, is a juristic entity. The decisions of the Company are taken by the Board of Directors of a Company. The Company acts through its Board of Directors, and an individual Director cannot don the mantle of the Company by acting on its behalf, unless he is so authorized to act by a special resolution passed by the Board or unless the Articles of Association so warrant. It is equally well settled that a Director of a Company though he owes a fiduciary duty to the Company, he owes no contractual duty qua third parties. There are, however, two exceptions to this rule. The first is where the Director or Directors make themselves personally liable, i.e., by execution of personal guarantees, indemnities, etc. The second is where a Director induces a third party to act to his detriment by advancing a loan or money to the Company. On the third party proving such fraudulent misrepresentation, a Director may be held personally liable to the said third party. It is, however, well settled that this liability would not flow from a contract, but would flow in an action

at tort, the tort being of misrepresentation and of inducing the third party to act to his detriment and to part with money.

12. This is the settled position ever since 1897 when the House of Lords decided the case of ***Salomon vs. Salomon & Co. Ltd. 1897 AC 22***, and Lord Macnaghten, observed as under: -

> "the company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by that Act."

13. However, with the passage of time inroads have been made into the aforesaid legal principle that the company is a legal entity distinct from its shareholders and directors and certain exceptions have been carved out. One such inroad is commonly described as lifting or piercing of the corporate veil. This has been succinctly put by the Supreme Court in ***Tata Engineering and Locomotive Co. Ltd. v. State of Bihar [1964]6SCR885*** as follows:

> "24. The true legal position in regard to the character of a corporation or a company which owes its incorporation to a statutory authority, is not in doubt or dispute. The Corporation in law is equal to a natural person and has a legal entity of its own. The entity of the Corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively

> for its own purpose; its creditors cannot obtain satisfaction from the assets of its members; the liability of the members or shareholders is limited to the capital invested by them; similarly, the creditors of the members have no right to the assets of the Corporation. This position has been well established ever since the decision in the case of Salomon v. Salomon and Co. was pronounced in 1897; and indeed, it has always been the well-recognised principle of common law. However, in the course of time, the doctrine that the Corporation or a Company has a legal and separate entity of its own has been subjected to certain exceptions by the application of the fiction that the veil of the Corporation can be lifted and its face examined in substance. The doctrine of the lifting of the veil thus marks a change in the attitude that law had originally adopted towards the concept of the separate entity or personality of the Corporation. As a result of the impact of the complexity of economic factors, judicial decisions have sometimes recognised exceptions to the rule about the juristic personality of the corporation. It may be that in course of time these exceptions may grow in number and to meet the requirements of different economic problems, the theory about the personality of the corporation may be confined more and more."

14. Similar observations were made by the Supreme Court in the case of ***New Horizons Ltd. v. Union of India***: ***(1995)1SCC478*** :

> "27. The conclusion would not be different even if the matter is approached purely from the legal standpoint. It cannot be disputed that, in law, a company is a legal entity distinct from its members. It was so laid down by the House of Lords in 1897 in the leading case of Salomon v. Salomon & Co. Ever since this decision has been followed by the courts in England as well as in this country. But there have been inroads in the

> doctrine of corporate personality propounded in the said decision by statutory provisions as well as by judicial pronouncements. By the process, commonly described as "lifting the veil", the law either goes behind the corporate personality to the individual members or ignores the separate personality of each company in favor of the economic entity constituted by a group of associated companies. This course is adopted when it is found that the principle of corporate personality is too flagrantly opposed to justice, convenience or the interest of the Revenue. (See : Gower's Principles of Modern Company Law, 4th Edn., p.112.) This concept, which is described as "piercing the veil" in the United States, has been thus put by Sanborn, J. in US v. Milwaukee Refrigerator Transit Co.4:
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> 'When the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.' "

15. The question therefore in the instant case is - Can the corporate veil be lifted in the present case to reveal the identity of the person or persons behind it? The respondents in their plaint have not made out any such case to justify the piercing of the corporate veil. Therefore, this matter is not required to be dwelt upon by this Court any longer.

16. The next question which arises for consideration is whether the appellants as Directors made themselves personally liable for the dues of the Company. Reference in this context may be made to the judgment of this Court in ***Tristar Consultants vs. Customer Services India Pvt. Ltd.***

And Anr., 139 (2007) DLT 688. Paragraphs 28 to 30 of the said judgment, which are apposite, read as under:-

> *"28. To interpret the law as is sought to be projected by the petitioner would mean negation of the concept of a company being limited by its liability as per the memorandum and articles of association of the company. Other than where directors have made themselves personally liable i.e. by way of guarantee, indemnity, etc. liabilities of directors of a company, under common law, are confined to cases of malfeasance and misfeasance i.e. where they have been guilty of tort towards those to whom they owe a duty of care i.e. discharge fiduciary obligations. Additionally, qua third parties, where directors have committed tort. To the third party, they may be personally liable.*
> *29. For example by making false representations about a company, a director induces a third party to advance a loan to the company. On proof of fraudulent misrepresentation, a director may be personally liable to the third party.*
> *30. But this liability would not flow from a contract but would flow in an action at tort. The tort being of misrepresentation of inducement and causing injury to the third party having induced the third party to part with money."*

17. In the case reported as ***Space Enterprises vs. M/s. Srinivasa Enterprises Ltd. 72 (1998) DLT 666***, this Court while dealing with the liability of the Directors of a company for the dishonor of cheques of the company, in a suit filed under Order XXXVII of the Code of Civil Procedure, made the following observations: -

> "11. In so far as the liability of defendant No. 2 is concerned, the effect of the registration of a company under Section 34 of the Companies Act is that it is a distinct and independent person in law and is endowed with special rights and privileges; a person distinct from its members. Consequently, the company is enabled to contract with its

> shareholders also, to use common seal and acquire and hold property in its corporate name. The company is distinct from its shareholders and its directors. Neither the shareholders nor the director can treat the companies assets as their own. Directors of a company are liable for misappropriation of company's funds and other misfeasance, but not for an ordinary contractual liability of the company. The liability of the members or the shareholders or the directors is limited to the capital invested by them. So long the liability is not unlimited under Sections 322 and 323 of the Companies Act and no special resolution of the limited company making liability of the directors or the managing directors unlimited is alleged. The doctrine of lifting of the corporate veil could be applied in cases of tax evasion, or to circumvent tax obligation or to perpetuate fraud or trading with an enemy are concerned. It is not alleged that the director has lost the privilege of limited liability and has become directly liable to the plaintiff i.e. creditor of the company on the ground that with his knowledge the company carries on business six months after the number of its members was reduced below the legal minimum number. In absence of such a case it would be totally inappropriate and improper to say that defendant No. 2 is patently covered under Order 37 CPC.
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> 12. There is no contract between the plaintiff and defendant No. 2. therefore, case against defendant No. 2 is not based on any contract nor there is any such liability on defendant No.2. Consequently, there is no cause of action against defendant No. 2. Since there is no cause of action against defendant No. 2, the plaint is liable to be rejected so far as defendant No. 2 is concerned."

18. In the instant case, there is admittedly no assertion in the plaint that the appellants had extended any contract of guarantee or had even undertaken to make payment to the respondents of the loan amount on behalf of the company, M/s. Dawson Leasing Limited. No case of joint and several liability is, therefore, made out and the liability, if any, is the

sole liability of the Company, which is stated to be under liquidation. There is also no denial to the fact that the respondent No.4 himself was one of the Directors of the Company and therefore part and parcel of the Company. When the decision to invite secured non-convertible debentures was taken by the Board, the names of the respondent No.4 and his brother appeared in the offer document issued on behalf of the Company. In such circumstances, merely because the respondent No.4 subsequently resigned as a Director, it is not open to the respondents to allege that they have been deceived and defrauded.

19. It is also well settled that fraud, if alleged, must be pleaded meticulously and in detail and proved to the hilt. A mere assertion that fraud has been committed is neither here nor there. Precisely and in what manner fraud has been committed is required to be delineated by the party alleging the same if the plea of fraud is to be made the basis of a decree against the other party. Bald assertions and vague allegations will not be countenanced by the Courts. Rule 4 of Order VI specifically lays down that the particulars of the fraud alleged (with dates and items, if necessary) shall be stated in the plaint.

20. To conclude, the instant case is not one in which the appellants could have been held jointly and severally liable as Directors to pay the amount invested by the respondents in the Company. The appellants are not even alleged to be guarantors or indemnifiers for payment of the amount due from the Company nor it is pleaded in the plaint that the respondents had undertaken to make payment on behalf of the Company.

As stated above, no particulars of fraud are set out, presumably for the reason that the respondent No.4 himself was a functional Director of the Company responsible for the day-today affairs of the Company. In such circumstances, in my considered opinion, it is the Company and the Company alone upon whom the liability can be fixed at all.

21. Accordingly, the appeal succeeds and the judgment and decree dated 18.09.2009 passed by the learned Additional District Judge are set aside qua the appellants No.1 and 2. The appellants are granted unconditional leave to defend the suit. The matter is remitted back to the trial court for being tried in accordance with law. Parties are directed to appear before the concerned Court on 20.09.2010.

22. RFA 14/2010 and CM No.495/2010 stand disposed of accordingly.

REVA KHETRAPAL
(JUDGE)

August 16, 2010
km/sk