

PROSECUTION OF COMPANIES IN LIQUIDATION FOR BOUNCING OF CHEQUES

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Introduction

An economic slowdown generally brings along an increase in cases relating to insolvency and financial offences. Once such offence is that of cheque bouncing, which is not uncommon these days. Another facet of economic slowdown is the steep rise in the number of winding-up of companies through courts. In case of companies, cheque bouncing and winding up are like twins which may be born, when a company's financial position is in doldrums. In this context, the special mention of Maharashtra and Delhi is necessary as these two regions together house the highest number of registered offices of companies limited by shares in India.¹ As per details released by the Bombay High Court, in Maharashtra alone, there were 4.68 lakh cheque bouncing complaints instituted for the period from 1 April, 2010, to 31 March, 2012. A similar situation can be seen in Delhi where, for the year of 2008, around 2.93 lakh cheque bouncing complaints were instituted.²

A situation may arise where a company may be facing both prosecution for cheque bouncing and a winding up through court. This may give rise to a number of questions relating both to the Companies Act, 1956, and the Negotiable Instruments Act, 1881. One of the most imposing questions is the relevance of section 446(1) of the Companies Act, 1956, while dealing with cheque bouncing issues. Attempt here is to analyze the law relating to applicability of section 446(1) of the Companies Act, 1956, and its bearing on continuance of complaints under section 138 of the Negotiable Instruments Act, 1881.

Application of section 446(1) of the Companies Act, 1956

Section 446 (1) of the Companies Act, 1956, provides that, when a winding up order has been made or the official liquidator has been appointed as provisional liquidator, no suit or other legal proceeding shall be commenced, or if pending at the date of the winding up order, shall be proceeded with, against the company, except by leave of the Company Court and would be subject to such terms as the Company Court may impose in that regard. The question that arises is whether proceedings for dishonour of cheque under section 138 of the Negotiable Instruments Act, 1881, require leave of the Company Court under section 446(1) of the Companies Act, 1956, to proceed further. The courts have taken divergent views based on varied arguments.

Interpretation of 'other legal proceedings'

The division bench of the Delhi High Court in *D.K. Kapur v Reserve Bank of India and others*³ held that 'other legal proceedings' must be read in *ejusdem generis*

¹ Ministry of Corporate Affairs, 56th Annual Report, On the Working and Administration of the Companies Act, 1956 year ended March 31, 2012, Statement – V, pages 81

² District Courts of Delhi, Annual Report 2008-09, page 22.

³ (2001) 1 Comp LJ 450 (Del).

to the expression 'suit' in section 446 of the Companies Act, 1956, and, therefore, no permission of the Company Court was required for filing a criminal complaint either against the company or against its directors. This decision was followed by the Delhi High Court in *R.N. Malhotra v Bhupesh Kumar Jain and others*⁴, in a case relating to dishonour of cheque.

But, in *GSL (India) Limited v Bayer ABS Limited*⁵, the single bench of the Gujarat High Court held that the principle of *ejusdem generis* cannot be invoked in case of interpreting section 446(1). Two reasons were given for the same. The High Court, firstly, considered a situation where the word 'suit' under sections 442 and 446 is taken to be used in narrower sense, *viz.*, institution of proceeding by filing a plaint in court to be conducted as per procedure prescribed in Code of Civil Procedure. The court observed that, in such a case, 'suit' would be only used as a specie (member) of genus (family), and not as genus, then in the absence of enumeration by two or more of species falling under same genus, it cannot be used as a basis to provide its colour to the words 'proceedings' that follows it. Secondly, the court considered a situation where the word 'suit' is used in its wider sense. The court observed that, in such a case, the term 'suit' will embrace all contentious proceedings of any civil kind, whether they arise in a suit under Code or any such proceedings under other statutes and, therefore, will exhaustively include within its ambit all proceedings of civil nature so as to limit the meaning of expression 'proceedings'. So construed, the expression 'proceedings', appearing after 'suit', will be mere surplusage if the expression is confined to 'civil proceedings' only, then the court applied the principle that any rule of interpretation which renders use of any word or words by legislature as surplus ought not to be accepted. The court found that a narrow interpretation to the word 'suit' does not give an apt meaning to the subsequent term 'proceedings'. Therefore the argument that the word 'proceedings' should be given a narrower meaning confining it to civil proceedings and exclude criminal proceedings by invoking maxim *noscitur a sociis* and *ejusdem generis* was not accepted by the Gujarat High Court.

The Andhra Pradesh High Court in the case of *Nagarjuna Finance Ltd. v Kanosika Laboratories Ltd. and another*⁶ sought to take the reference of to section 17 of the Provincial Insolvency Act which is an identical provision to section 446 of the Companies Act, 1956. The said section 17 of the Provincial Insolvency Act provides that after an adjudication order is made, no creditor shall commence any suit or 'other legal proceedings' against the insolvent, so adjudicated, without leave of the court. In regards to interpretation of section 17 of the Provincial Insolvency Act, the Bombay High Court in *Emperor v Mulshanker*⁷ had

⁴ (2013) 3 RCR (Civil) 622.

⁵ (1999) 2 Comp LJ 281 (Guj); (2000) 38 CLA 290.

⁶ (1998) 4 Comp LJ 458 (AP); AIR 1998 AP 396.

⁷ ILR 35 Bom 63.

specifically had held that no leave of court is necessary in order to institute criminal proceedings against the insolvent and the term 'other legal proceedings' does not cover criminal proceedings. Taking this reference the Andhra Pradesh High Court held that for prosecuting pending criminal proceedings under section 138 of the Act against a company, no leave is required to be obtained from the Company Court.

In fact in, *In re Pennar Paterson Ltd.*⁸ the division bench of the Andhra Pradesh High Court held that the Company Court has no jurisdiction to transfer a criminal case from one State to another and the expression 'other legal proceedings' occurring in section 446(1) does not embrace within its fold a criminal prosecution. The High Court relied on the Supreme Court decision of *BSI Ltd. and another v Gift Holdings (P) Ltd. and another*⁹ where the Supreme Court was dealing with the question whether a cheque bouncing criminal complaint can be continued in light of section 22(1) of the Sick Industrial Companies (Special Provisions) Act, 1985, which provides for stay of suit or other legal proceedings in case of the Board for Industrial Finance and Reconstruction or the Appellate Authority is approached. In that case, the Supreme Court held that if commission of the offence under section 138 of the Negotiable Instruments Act, 1881, was completed before the commencement of proceedings under section 22(1) of Sick Industrial Companies (Special Provisions) Act, 1985, and there is no hurdle under the same against the maintainability and the prosecution of a criminal complaint duly instituted under section 142 of the Negotiable Instruments Act, 1881.

This Andhra Pradesh High Court decision was challenged before the Supreme Court in *Pennar Paterson Ltd. v Shikshak Sahakari Bank Ltd.*¹⁰ The Supreme Court dismissed the appeal on the ground that the High Court's reasoning based on *BSI Ltd. and another v Gift Holdings (P) Ltd. and another*¹¹ was sound and that the appeal lacked merits.

Impact on the assets of the company

In *K.P. Devassy v Official Liquidator and others*¹², the Kerala High Court has held that though the words 'legal proceedings' in section 446 of the Companies Act are wide enough to embrace criminal prosecution but only if they are in relation to the assets of the company. Since the proceedings under section 138 of the Negotiable Instruments Act can end only in the conviction or acquittal of the accused in the case and no recovery of any amount covered by the dishonoured cheques can be made in the criminal case. Therefore, it is purely a personal act by the creditors against the person who issued the cheques.

⁸ Andhra Pradesh High Court, Company Application Nos. 179 and 188 of 2001 and Company Petition No. 131 of 1999.

⁹ (2000) 2 Comp LJ 13 (SC).

¹⁰ (2010)101 SCL 290 (SC).

¹¹ (2000) 2 Comp LJ 13 (SC).

¹² (1998) 2 Comp LJ 315 (Ker).

The issue is more aptly answered by the Bombay High Court in *Firth (India) Steel Co. Ltd. (in liquidation)*¹³, where the court also considered the scope of fine imposed on the company in liquidation, under section 138 of Negotiable Instruments Act. The court held that merely because a fine may be imposed which will have to be paid from the assets of the company, it cannot be contended that the Company Court in winding up would have jurisdiction to stay the criminal prosecution or that permission of the Company Court is required to prosecute the company for offences committed before a provisional liquidator is appointed or an order of winding up is made. However, the court further held that if a fine is imposed on the company then realisation of such fine would be under the provisions of the Land Revenue Code which would be other legal proceedings. For the same sale, attachment of the property of the company would be undertaken which would be subject to section 537 of the Companies Act. It is these other legal proceedings which the Company Court could look into as it would have a bearing on the assets of the company.

Special law would override the general law

The division bench of the Kerala High Court in *Jose Antony Kakkad v Official Liquidator, High Court of Kerala and another*¹⁴ observed that section 138 to section 142 of the Negotiable Instruments Act were incorporated with the intention of safeguarding and sustaining the credibility of commercial transactions and those provisions were introduced while section 446 of the Companies Act was in force. It was further observed that when specific provision has been made with respect to the commission of an offence under section 138 by a company or its directors or its employees, it has to be presumed that Parliament introduced the above provisions in the Negotiable Instruments Act fully knowing that section 446 was there in Companies Act and therefore section 141 of the Negotiable Instruments Act would have an overriding effect on section 446 of the Companies Act.

The Madras High Court in *Counter Point Advt. (P) Ltd. v Harita Finance Limited*¹⁵ held that the Negotiable Instruments Act is a Special Act which overrides the provisions of the Companies Act. Further it was observed that the legal liability contemplated under section 446 of the Companies Act does not synchronise with the criminal proceedings under the Negotiable Instruments Act and that the personal criminal liability and not the civil liability of the company is enforced under section 138 read with section 142 of the Negotiable Instruments Act. It was further observed that the company and its Directors cannot shirk their criminal liability on the ground that the company was already wound up and the Official Liquidator had taken charge of the affairs of the company.

¹³ AIR 1999 Bom 75.

¹⁴ (2008) 3 Comp LJ 502 (Ker).

¹⁵ (2006) Cri LJ 2289.

Company Court to be informed

The Allahabad High Court in, *In re Rajinder Steels Ltd. (in liquidation)*¹⁶, has held that the permission under section 446 of the Companies Act needs to be sorted to continue prosecution under section 138 of the Negotiable Instruments Act, 1881. The High Court observed that that the object of section 446, is to facilitate the protection and realisation of the assets of the company with a view to ensure equitable distribution of the realisations thereof to the creditors, workmen and shareholders, and others. The High Court was of the view that, even if the Company Court cannot take cognizance of the offence under section 138 of the Negotiable Instruments Act, 1881, it must at least be informed about the misfeasance committed by the director in the matter of issuing dishonoured cheques from the account of the company, and that it is only where permission is requested that Company Court can be informed of such proceedings.

The appropriate view and the way ahead

From the above discussion the generally accepted view is that leave of the Company Court under section 446 of the Companies Act, 1956, would not be required to proceed further with a complaint under section 138 of the Negotiable Instruments Act, 1881. In case of deciding in favour of continuing with the complaint against the company in liquidation, the complainant would have to move an application impleading the official liquidator to represent the company under section 305 of the Criminal Procedure Code, 1973, and then amend the complaint subsequently.

Relevance with regards to the Companies Act, 2013

The Companies Act, 2013, in section 279, almost replicates the provisions of section 446 of the Companies Act, 1956, as to commencement and proceeding of a suit or other legal proceeding against a wound up company. Therefore, the plethora of judgments with regards to cheque bouncing cases and section 446 of the Companies Act, 1956, can be read during the interpretation of section 279 of the Companies Act, 2013. One major change is that although the section 446(2) of the Companies Act, 1956, expressly gave jurisdiction to the tribunal to entertain or dispose of suits, claims against the company, such a provision is absent in section 279 of the Companies Act, 2013. Therefore the National Company Law Tribunal can only decide on whether leave is to be granted or not on commencement or proceeding with a suit or other legal proceedings but not entertain or dispose them on merits. Further, the Tribunal has to mandatorily dispose of the application for leave under section 279 within sixty days.

¹⁶ (2007) III BC 643.