

IN THE SUPREME COURT OF INDIA

(Civil Appellate Jurisdiction)

Civil Appeal No. 1481 of 2018

Official Liquidator, Mehta Aeronautics Pvt Ltd

...Appellant

versus

Seymour & Fitch plc

...Respondent

Civil Appeal No. 1482 of 2018

Official Liquidator, Mehta Aeronautics Pvt Ltd

...Appellant

versus

Suresh Krishnan

...Respondent

1. Mehta Aeronautics Pvt Ltd is a private company that was incorporated in Mumbai in 2012. Before the events that gave rise to this litigation, the company ('MAPL') specialised in the manufacture of helicopters and short-range commercial aircraft. MAPL was the brainchild of Captain Kapil Mehta.
2. Captain Mehta began his career as a pilot at Air India in 1981. There was a complaint about his probity in 1995 but an internal disciplinary inquiry concluded that he had no case to answer because there was insufficient evidence in support of the complaint. Having apparently put this incident behind him, Captain Mehta made rapid progress and by 1998 had become a senior commander regularly rostered to fly some of Air India's most prestigious international routes on its best aircraft.
3. By 2000, Captain Mehta was actively considering retirement or at least a different job, largely because the lifestyle of an international pilot did not suit him. This was, unlike for many of his contemporaries, a realistic option for Captain Mehta because he had over the years acquired considerable expertise in the aviation industry including,

unusually for a pilot, the manufacturing side of the industry. A second career in this field was something he had been contemplating for some time. Coincidentally, Airbus was at the time also looking to recruit senior employees with a good relationship with Indian airlines as it thought that this would improve its ability to compete with Boeing in the Indian market, which was of increasing importance in view of its size and expected growth.

4. In 2001, headhunters acting on behalf of Airbus approached Captain Mehta to invite him to join Airbus' Commercial Aircraft division in Toulouse as a senior consultant, with a particular focus on: (a) the development and manufacture of its short-range aircraft (such as the A320); and (b) its India business. Captain Mehta accepted this offer and relocated to France to take up this post. He thought that his stint at Airbus would be of assistance in eventually pursuing entrepreneurial ambitions that he had always nursed. His goal was to establish a start-up in India focusing on the manufacture of helicopters and short-range commercial aircraft and his view was that there was probably no better preparation for this than a stint at either Airbus or Boeing. This opportunity seemed therefore to tick all the boxes.
5. Captain Mehta's initial contribution to Airbus was, by all accounts, valuable and he was awarded substantial bonuses. But he soon became something of a controversial figure because some of his superiors felt that he had a problem with authority and appeared at times to be indifferent to the need to comply scrupulously with legal and ethical obligations. One incident that was often cited in this context (and indeed recorded in his confidential personnel file) was his reaction to a presentation that Airbus had arranged for its English solicitors to make to various Airbus teams in 2007. The presentation concerned Airbus' obligations under new anti-bribery legislation that had been or was soon likely to be introduced in several jurisdictions in Europe. Captain Mehta was overheard saying to a colleague at the presentation that some of this advice was wholly impractical because making 'facilitation payments' is, in some jurisdictions, inevitable and (in his view) '*simply how business is done*'.
6. In August 2008, Captain Mehta was summarily dismissed by Airbus for gross misconduct. This was because it had recently come to light to his immediate superior that Captain Mehta had (a) made certain misrepresentations about his background and experience when he was recruited; and (b) violated company policy in December 2007

by forwarding confidential documents to his personal email account. Airbus, partly to avoid the adverse publicity that any litigation would generate, entered into a settlement agreement under which Captain Mehta agreed to leave Airbus immediately, without compensation, and to return all confidential information, in return for Airbus' agreement not to initiate any civil or criminal proceedings against him in any jurisdiction.

7. Captain Mehta returned to India in 2009 with his reputation largely intact because the real circumstances of his departure from Airbus were not widely known. He declared to friends and industry journals that the reason he had returned was his desire to pursue his entrepreneurial ambitions and that his intention was to form a company in India in the next few years to manufacture helicopters and (eventually) short-range aircraft.
8. When MAPL was incorporated in 2012, Captain Mehta was clear in his mind that it should begin life as a private company in which his writ reigns supreme. He did not want to list the company or (for reasons that are perhaps more obvious now than they were then) even expose it to the regulatory control to which public companies are subject under Indian company law. MAPL would, of course, require a very substantial injection of funds—which might have been a reason to form a public company and later list it—but his intention from the outset was to raise these funds in the form of debt rather than equity. He anticipated that it would be difficult to obtain credit in the conventional way from banks or other financial institutions but thought that MAPL might well be of interest to smaller banks, especially those which specialised in funding relatively high-risk start-ups.
9. Accordingly:
 - (1) The issued share capital of MAPL consisted of 100,000 equity shares of Rs. 100 each.
 - (2) 99,999 shares were allotted to Captain Mehta and 1 share to his close associate and confidant, Alok Sharma.
 - (3) The Articles of Association of MAPL ('the Articles') provided that the board would consist of three directors.

- (4) Clause 18.1 of the Articles provided that the directors were authorised to receive remuneration in accordance with the terms of their contracts of employment. Clause 18.2 provided that the board of directors had the power, acting unanimously, to pay a ‘special bonus’ each year (over and above remuneration otherwise payable under clause 18.1 and the contract of employment) to directors holding executive posts such as CEO, MD or CFO.
10. Pursuant to these provisions, Captain Mehta, Mr Sharma and one Suresh Krishnan were appointed as MAPL’s whole-time directors. Mr Krishnan was to be Chairman of the Board and Captain Mehta and Mr Sharma were appointed MD/CEO and CFO respectively.
11. Mr Krishnan was a respected figure in the Indian business community. He had retired in 2008 as the CEO of India’s leading helicopter charter service. Following his retirement, he had devoted much of his time to charitable work and was generally regarded, both in India and elsewhere, as a trustworthy and able businessman. He had declined many offers from well-known Indian companies to join the board as a whole-time or independent director principally because he wanted to focus on his charitable work. When Captain Mehta approached him, he was, for this reason, initially reluctant to join MAPL. He also had some reservations about Captain Mehta’s background, since he had heard rumours that Captain Mehta had not left Airbus on good terms. But Mr Krishnan was eventually persuaded to join MAPL because aeronautics was, of course, close to his heart and Captain Mehta presented MAPL as an ambitious project designed to provide the Indian military with indigenous helicopters and (eventually) Indian commercial airlines with a home-grown alternative to Airbus and Boeing. Captain Mehta was also able to convince Mr Krishnan that he had chosen to leave Airbus to pursue his entrepreneurial ambitions and had done so on good terms. In addition, Mr Krishnan was reassured by Captain Mehta’s representations that the post of Chairman was largely ornamental and would only make a modest demand on his time, since the company would essentially be run by Captain Mehta. Mr Krishnan’s recruitment was a real coup for MAPL because his involvement improved its credibility and would no doubt enhance its ability to raise funds—crucial in the aeronautics business—whether from banks or venture capital funds.

12. MAPL's first year in business (the year ended 31 March 2013) produced encouraging results: it made a smaller net loss than is customary for a new aeronautics business, had developed relationships with important figures in the Government and filed patent applications in India and elsewhere for new generation short-range aircraft which it expected to begin to produce in 2020. Even some of Captain Mehta's critics, of which there were many, acknowledged that MAPL had made a promising start. In April 2013, the board unanimously resolved to pay a special bonus of Rs. 75 lakhs and Rs. 50 lakhs to Captain Mehta and Mr Sharma, respectively.
13. Although MAPL's efforts to raise funds had not borne fruit initially, the company was, in the light of its first-year results, of increasing interest to smaller banks and venture capital funds. A consortium of banks ('the Consortium'), led by a private bank that specialised in making loans to relatively high-risk start-ups in the aviation sector, conducted a detailed due diligence exercise and, following several rounds of negotiations with Captain Mehta, agreed in July 2013 to lend Rs. 450 crores to MAPL. This funding arrangement was negotiated entirely by Captain Mehta, with the assistance of Mr Sharma: Mr Krishnan had no role in the negotiations. A Facility Agreement was executed shortly thereafter and the money was drawn down by MAPL by late 2013.
14. In February 2014, MAPL entered into a technology acquisition agreement ('the TAA') with Fenlake Technology Ltd, a company incorporated in the Cayman Islands. Captain Mehta acted on MAPL's behalf in entering into this contract. He was assisted by Mr Sharma who, like Captain Mehta, was intimately familiar with the provisions of the TAA and its true nature, although Mr Krishnan, who had intentionally been kept in the dark, was not. Under the TAA, Fenlake agreed to sell to MAPL: (a) equipment which would enable MAPL to outfit the fuselage sections of its aircraft more efficiently; and (b) certain patents Fenlake had obtained for other cutting-edge technology. MAPL agreed to pay Fenlake a sum of Rs. 75 crores as the sale price. Fenlake provided a detailed valuation report to MAPL indicating that the value of the technology and patents transferred to MAPL under the TAA was likely to exceed Rs. 100 crores within four years. The sale price was paid by MAPL on 10 March 2014.
15. In mid-2014, there were rumours of financial impropriety in the management of MAPL's affairs and in particular in the use it had made of the funds obtained pursuant

to the Facility Agreement. There was also some concern about the fact that MAPL's net loss for the year ended 31 March 2014 was marginally higher than expected. Captain Mehta firmly denied these rumours. He pointed out that the statutory accounts did not reveal any impropriety and that losses in the initial years were the norm for companies in any industry with a long gestation period. The Consortium was inclined to believe him but out of an abundance of caution asked him to commission an independent investigation into the affairs of MAPL so that the Consortium could satisfy itself that its money was safe. This was not something that Captain Mehta wished to do but he realised that he had no real alternative because the Consortium was entitled under the provisions of the Facility Agreement to accelerate the loan and terminate the contract in the event of MAPL's refusal to permit an investigation into its affairs.

16. The Consortium suggested to Mr Mehta that the investigation be undertaken by Seymour & Fitch plc, a well-known firm of forensic accountants incorporated in Ruritania¹ and with offices in London, New York and Paris. Accordingly, Seymour & Fitch were instructed by MAPL in June 2014 to investigate the circumstances in which the TAA was entered into. MAPL's contract with Seymour & Fitch was expressly governed by Ruritanian law but did not contain any jurisdiction or arbitration agreement.
17. Seymour & Fitch conducted what appeared at the time to be a detailed and careful investigation over the summer and autumn of 2014. They presented a report to the MAPL Board on 14 January 2015 which concluded, in essence, that there was no evidence of any financial impropriety and that the price paid to Fenlake under the TAA was not excessive in the circumstances. This report was of considerable reassurance to both Mr Krishnan and the Consortium.
18. MAPL made a net loss of about Rs. 4 crores in the year ended 31 March 2015. In April 2015, Captain Mehta proposed at a board meeting of MAPL that a 'special bonus' of Rs. 20 crores and Rs. 10 crores be awarded to himself and Mr Sharma, respectively. Mr Krishnan expressed some reservations at this proposal, noting that this could not lawfully have been paid as dividend because there were no distributable profits and that

¹ Ruritania is a common law jurisdiction whose courts regard the decisions of the English courts as highly persuasive.

it might potentially affect the interests of creditors if MAPL's business did not prosper. Captain Mehta's response was that the question of distributable profit was irrelevant because this payment was remuneration, not dividend, and that it was in the interests of the company for key executives to receive adequate remuneration. Mr Krishnan reluctantly went along with this, largely because he knew from personal experience that it is normal for companies in any aspect of the aviation or aeronautics industry to need several years to become profitable. The special bonus proposal accordingly had the unanimous support of the board and was implemented immediately.

19. On 16 October 2015, *The Economic Times* ran a sensational story suggesting that Captain Mehta, with the knowledge and assistance of Mr Sharma, had been using MAPL to perpetrate a very substantial fraud on its creditors, notably the Consortium. The story was based on confidential information *The Economic Times* said it had received from an anonymous whistleblower at MAPL and the allegations it made included the following: (a) the whistleblower was in possession of documents suggesting that Captain Mehta had intended virtually from the outset to use MAPL as a vehicle to defraud creditors and misappropriate its funds for his personal use; (b) the TAA was a related-party transaction: the patents and technology that MAPL had purported to buy were in reality worthless and a cover for MAPL to pay substantial sums of money to a company (Fenlake) ultimately controlled by offshore trusts of which Captain Mehta and his family were the sole beneficiaries; and (c) MAPL's losses in 2013, 2014 and 2015 were significantly higher than its audited accounts indicated.
20. Warrants were issued for the arrest of Captain Mehta and Mr Sharma but it transpired that the former had left the country two weeks before the story broke. He had a home in Melbourne and it was expected that having him extradited from Australia would involve protracted and complex proceedings. Mr Sharma however was arrested in October 2015 and soon confessed to the police that the whistleblower's allegations were, in essence, true: Captain Mehta had used MAPL as a vehicle to defraud creditors and the statutory accounts were inaccurate because the auditors had been given false information and shown forged documents. He also made it clear that while he (Mr Sharma) had assisted Captain Mehta, Mr Krishnan had no knowledge of these matters.
21. The Consortium, which was MAPL's biggest creditor, was understandably concerned by these developments and took immediate steps to protect itself. It invoked an

acceleration clause in the Facility Agreement, as it was entitled to do, and served a notice on MAPL requiring the entire amount outstanding to be repaid immediately. But it was obvious by early 2016 that MAPL's liabilities, principally though not only to the Consortium, substantially exceeded its assets and that liquidation was inevitable. The Consortium presented a winding-up petition to the Bombay High Court on 19 January 2016. Following service of the petition and a hearing, the Bombay High Court made an order on 21 April 2016 for the winding-up of MAPL and a copy of the order was sent to the Official Liquidator shortly thereafter.

22. The Official Liquidator began investigating the affairs of MAPL and formed the view that MAPL had a potentially valuable claim against Seymour & Fitch, which had evidently failed to detect (at least) the Fenlake fraud, and perhaps also against its statutory auditors who had certified the 2013, 2014 and 2015 accounts as true and fair. Having taken legal advice, the Official Liquidator sent a pre-action letter on 14 May 2016 to Seymour & Fitch. He also sent a pre-action letter to Mr Krishnan alleging that his approval of the proposal in April 2015 to pay the 'special bonus' to Captain Mehta and Mr Sharma was a breach of his duties as a director of MAPL.² No such allegation was made in relation to the 2013 special bonus.
23. Seymour & Fitch was aware of some of these developments (in view of the wide publicity) and had already taken legal advice. Immediately after it received the pre-action letter from the Official Liquidator, it commenced proceedings against MAPL in the Commercial Court in Ruritania City, the capital of Ruritania, seeking a declaration of non-liability, i.e., a declaration that it had not acted negligently and was not in breach of contract in conducting its investigation.
24. This came as something of a surprise to the Official Liquidator who had, of course, intended to pursue the claim against Seymour & Fitch in the Bombay High Court (or if necessary in the NCLT) as part of the winding-up proceedings, not in Ruritania. Having taken advice from Ruritanian solicitors, he decided that MAPL should participate in the Ruritanian proceedings for the limited purpose of challenging the jurisdiction of the

² The Official Liquidator was reluctant to pursue claims against Captain Mehta and Mr Sharma in the first instance because he thought that they, unlike Mr Krishnan, would probably not have sufficient assets to satisfy a judgment against them. Seymour & Fitch was also an attractive defendant because it had deep pockets and, of course, carried professional liability insurance.

Commercial Court and seeking a stay of proceedings on the ground that the Indian court was the *forum conveniens*. Accordingly, MAPL³ filed an acknowledgment of service on 19 September 2016, expressly indicating that it was doing this (as it was required to under the Ruritanian Civil Procedure Rules) solely for the purpose of contesting jurisdiction and seeking a stay. On 30 September 2016, it issued an application challenging the jurisdiction of the Commercial Court and seeking a stay of the Ruritanian proceedings on the ground that Ruritania was not the proper forum for the determination of this dispute.⁴ MAPL did not serve a defence or in any other way plead to the merits of the dispute.

25. Following an expedited hearing in the Commercial Court, Spencer J gave judgment on 20 December 2016 refusing MAPL's application. As for jurisdiction, he held that the Ruritanian court clearly had jurisdiction under the relevant jurisdictional gateways in the Ruritanian Civil Procedure Rules. As for *forum conveniens*, he accepted that nearly all the contemporaneous documents were in India, as were the critical witnesses, but concluded that MAPL had failed to demonstrate that the Indian court was a clearly or distinctly more appropriate forum than the Ruritanian court. MAPL decided not to challenge Spencer J's order.⁵ It took no further part in the Ruritanian proceedings.
26. On 19 March 2017, trial (without MAPL's participation) commenced before Spencer J, who heard evidence from Seymour & Fitch's factual and expert witnesses. He gave judgment on 30 March 2017 ('the Spencer Judgment') finding that Seymour & Fitch had not acted negligently or in breach of contract because the Fenlake fraud had been concealed so effectively that it could not reasonably have been detected by a forensic investigator at the time. He also held that MAPL's claim was in any event barred by the defence of illegality, which he found to be governed by Ruritanian law, not Indian law. Accordingly, Spencer J granted a declaration of non-liability and awarded Seymour &

³ Through the Official Liquidator. Ruritanian law incorporates the UNCITRAL Model Law on Cross-Border Insolvency. The Ruritanian court made an order recognising the Indian proceedings as the foreign main proceedings: the Official Liquidator was accordingly able to represent MAPL in the Ruritanian courts.

⁴ There were other grounds on which MAPL could have sought a stay (e.g. pursuant to the Model Law on Cross-Border Insolvency) but it did not pursue these because it was advised that there was a risk of being treated as having submitted to the jurisdiction of the Ruritanian court by taking such points.

⁵ Because it was advised by counsel that there was no realistic prospect of successfully challenging the order in the Court of Appeal.

Fitch its costs of the action. MAPL did not seek permission to appeal this order, which is therefore final as a matter of Ruritanian law.

27. In the meantime, the Official Liquidator, with the sanction of the Bombay High Court, had, in February 2017, issued applications in MAPL's name in that court⁶ against: (a) Seymour & Fitch, seeking damages for what was said to be its negligent investigation; and (b) Mr Krishnan, seeking compensation for what was said to be the breach of his duties as a director in approving the special bonus in April 2015. Following the conclusion of the Ruritanian proceedings, Seymour & Fitch's two principal defences were that MAPL was bound by the Spencer Judgment and that the claim was in any event barred by the illegality defence because it was founded on the illegal and criminal conduct of Captain Mehta, which was attributable to MAPL, a '*one-man company*'. Mr Krishnan's principal defence that any breach of duty on his part in approving the special bonus had been informally ratified by the shareholders acting unanimously.
28. A single judge of the Bombay High Court (sitting as the company judge) heard both claims together and gave judgment on 29 November 2017. In relation to the Seymour & Fitch claim, the single judge held that:
 - (1) The Spencer Judgment is not entitled to recognition in India because the Ruritanian court was not a court of competent jurisdiction as a matter of Indian private international law.
 - (2) MAPL's claim is not barred by the illegality defence because: (a) the conduct of Captain Mehta is not attributable to MAPL; and (b) even if it is attributable, the claim against Seymour & Fitch is not in the circumstances barred. The law governing the illegality defence is Indian law but the result would be the same even if it were Ruritanian law.

⁶ The winding-up proceedings in the Bombay High Court (commenced on 19 January 2016) were not transferred to the NCLT in the light of rules 5 and 6 of the Companies (Transfer of Pending Proceedings) Rules 2016. There is no issue in this litigation about whether the proceedings should have been transferred. Since the matter remained in the Bombay High Court, MAPL (through the Official Liquidator) issued the claims against Seymour & Fitch and Mr Krishnan in that court rather than in the NCLT. Again, there is no issue in these proceedings about the Bombay High Court's jurisdiction to entertain these claims.

- (3) Seymour & Fitch were in breach of contract and negligent in conducting the investigation because they failed to pursue obvious red flags and notably took no steps to ascertain the identity of the beneficial owners of Fenlake.
 - (4) MAPL is accordingly entitled to damages for any loss caused by that breach. The assessment of damages is stayed pending any appeals by Seymour & Fitch.
29. In relation to the claim against Mr Krishnan, the single judge held that:
 - (1) As a whole-time director, Mr Krishnan owed a number of fiduciary and other duties to MAPL. His decision to approve the special bonus in 2015 was a breach of his duty under section 166(2) and section 166(3) of CA 2013 because the payment of such a special bonus was plainly not in the interests of the company.
 - (2) Although Mr Krishnan did not know this at the time, it is apparent from the financial information now available that MAPL was on the verge of insolvency in April 2015: it was cash flow solvent but very close to balance sheet insolvency (though not actually insolvent) because its assets were only marginally in excess of its liabilities, which had been understated in its accounts. The ‘duty to consider the interests of creditors’ had therefore been triggered and the shareholders were not entitled (even unanimously) to ratify Mr Krishnan’s breach of duty under section 166(2) and section 166(3). The ratification defence therefore fails.
 - (3) Mr Krishnan is accordingly liable to pay MAPL Rs. 30 crores, which is the amount of the special bonus he voted to pay to Captain Mehta and Mr Sharma.
30. Seymour & Fitch and Mr Krishnan both challenged the single judge’s order. A Division Bench of the Bombay High Court heard both appeals together and gave judgment on 12 July 2018.
 - (1) In relation to the Seymour & Fitch claim, it held that:
 - (a) The single judge’s factual finding that Seymour & Fitch conducted its investigation negligently and in breach of contract (see para 28(3) above) is correct.
 - (b) However:

- (i) The Spencer Judgment is entitled to recognition in India and conclusive because MAPL submitted to Ruritanian jurisdiction by making its application dated 30 September 2016 in the Commercial Court. MAPL is therefore bound by the declaration of non-liability.
 - (ii) Even if the Spencer Judgment is not entitled to recognition in India, Captain Mehta's conduct is in any event attributable to MAPL⁷ and its claim against Seymour & Fitch is barred by the defence of illegality, which is governed by Ruritanian law, not Indian law.
 - (c) Accordingly, Seymour & Fitch's appeal was allowed and the single judge's order set aside.
- (2) In relation to the claim against Mr Krishnan, the Division Bench held that:
- (a) The single judge was correct in finding that Mr Krishnan had acted in breach of his duties under section 166(2) and 166(3).
 - (b) However, since Captain Mehta and Mr Sharma were also parties to the decision to pay the special bonus, any breach of duty by Mr Krishnan was unanimously ratified by the shareholders. The duty to consider the interests of creditors, if any, did not prevent ratification.
 - (c) Accordingly, Mr Krishnan's appeal was allowed and the single judge's order set aside.

31. MAPL filed a special leave petition before the Supreme Court of India seeking to challenge the Division Bench's order in both claims. At the admission hearing, the Supreme Court granted leave and made an order that the two MAPL appeals should be

⁷ It held, in this context, that MAPL was in effect a 'one-man company' because, of the two other directors, Mr Sharma was complicit in the fraud and Mr Krishnan, though entirely innocent of any fraud, never exercised any real influence over the management of the company. As the Division Bench put it, 'MAPL was Captain Mehta's show'.

heard together.⁸ It also indicated to counsel that it wishes to hear argument on the following issues⁹ at the final hearing:

- (1) Is the Spencer Judgment entitled to recognition and conclusive in India?
 - (2) If not, does MAPL's claim against Seymour & Fitch fail in any event by reason of the defence of illegality? In particular:
 - (a) Is the defence of illegality governed by Indian law or Ruritanian law?
 - (b) Is MAPL's claim barred by the defence of illegality under the applicable law (Indian or Ruritanian, as the case may be)?
 - (3) Is Mr Krishnan entitled to rely on the defence of ratification even though MAPL was, in April 2015, in a precarious financial position (though not actually insolvent)?
32. In view of the importance of the issues of law that arise, the Chief Justice of India has directed that MAPL's appeals be listed for final hearing in January 2019 before a bench comprising five judges.

⁸ Seymour & Fitch and Mr Krishnan were refused leave to challenge the factual findings summarised above at paras 30(1)(a) and 30(2)(a), respectively.

⁹ The first two issues arise in Civil Appeal No. 1481 of 2018 and the third in Civil Appeal No. 1482 of 2018.