

The 7<sup>th</sup> ICSI ALL INDIA MOOT COURT COMPETITION 2009 - PROBLEM

IN THE HIGH COURT OF BOMBAY  
C.S. NO. 27 of 2009

IN THE MATTER OF:

***RIMS BANK, Luxembourg***

***....Plaintiff***

**Vs.**

***Earnest Leathers (India) Ltd & Others***

***....Respondents***

1. Earnest Leathers (India) Ltd (ELIL), incorporated in 1989 in Mumbai, was the flagship company of the Earnest Group, which was largely a family-owned business syndicate, founded by the legendary late Shri. Ravi Emani and his 3 sons. Towards the end of the 20<sup>th</sup> century, the third-generation entrepreneurs in the family started taking up prominent positions in the group companies leading to the infusion of fresh and ambitious ideas for growth.
2. The youngest grandson of the founder, Sripat Emani was the last to join the fray as Executive Chairman-New Projects, ELIL in 2005. His brother Srimath and sister Preeti, were already actively involved in the leather business and together, the three siblings, directly and indirectly, controlled around 75% of the share capital in ELIL. Srimat and Preeti had also been on the Board of ELIL for about 6 consecutive years.
3. In 2006, Sripat Emani announced the undertaking of a new venture in Luxembourg with the object of catering to the European market for leather goods. While ELIL already had a few tie-ups in Europe, exports had not achieved their fullest potential. Sripat was confident of success in the highly fashion-conscious European sub-continent and even proposed the setting up of a wholly-owned subsidiary in Luxembourg with a full-fledged manufacturing set-up for customizing leather products to suit Western taste and style parameters.
4. The ELIL Board (with a diverse mix of the young and the old in the family) however, found it hard to accept or approve such radical steps without due consideration over a period of time. On the other hand, for Sripat, even the slightest delay meant missed opportunities. Therefore, it was decided that Sripat would go it alone in the European market with a bit of technical and financial support from ELIL.
5. The financial support was to come in the form of a corporate guarantee from ELIL in favour of RIMS Bank, Luxembourg, which was financing debt capital to the tune of €1,47,500.00 for the new venture. The new venture was to have a 50:50 capital structure with equal proportions of debt and equity. Apparently, RIMS was insisting on a corporate guarantee from the group's most prestigious and profitable company with a view to cushion its exposure.
6. It was agreed with the ELIL Board that the corporate guarantee from ELIL (hereinafter "corporate guarantee") would only operate as a last-resort security over and above personal guarantees of Sripat, Srimat and Preeti and other securities being furnished to the Bank. A resolution was passed to that effect by the ELIL Board at the meeting held on 23.08.2006 while recording an in-principle approval of the terms of the corporate guarantee as required by RIMS. (Text of the resolution attached in Annexure.)
7. With the financial issues sorted out, the new company was incorporated as Earnest LF.S.A.R.L (hereinafter 'ELF Luxembourg') on 22.09.2006 with a share capital equivalent to INR 10 million held as follows:

S. #	Name of Shareholder	Shareholding
1	Sripat Emani	90%
2.	Srimat Emani	6%
3.	Preeti Emani	4%

The loan was sanctioned by RIMS on 29.12.2006 and as a pre-condition to the loan agreement; a corporate guarantee dated 27.12.2006 was entered into between the parties concerned.

8. ELF Luxembourg did not get off to a great start and a number of teething problems cropped up. Delays were occasioned in the technical tie-up with the Indian arm for processing of raw leather and this resulted in consequential delays in the setting up of the manufacturing plant and the off take of equipment from suppliers. As a result, the company did not commence any business activity till October 2008, apart from having made a part payment for the purchase of some equipment for the manufacturing facility.
9. The global economic crisis had its share of negative impact on the prospects & outlook for ELF Luxembourg. It also stepped up the pressure on RIMS to monitor all loan accounts and initiate actions for recovery in case of defaults. In the course of such monitoring by the bank's internal asset review team, serious concerns were raised with respect to the ELF Luxembourg account, which was showing consecutive defaults in interest payments for the last 4 quarters. An enquiry revealed that business had not commenced and there seemed little likelihood of commencement in the near future. Chances of servicing/repayment were abysmally low as it was not possible to trace the ends to which the funds had been applied.
10. It was under such circumstances that RIMS started pursuing its remedies under the securities furnished by ELF Luxembourg. Due to the lack of clarity on the title to the plant and equipment reportedly purchased by ELF Luxembourg, it was decided to invoke the corporate guarantee. Accordingly, by letter-dated 12.11.2008 addressed to the Chairman and Managing Director, Mr. Srimat Emani, RIMS called upon ELIL to honour the corporate guarantee issued in its favour. To its shock, it received a response disclaiming all association or liability for the debts of ELF Luxembourg.
11. RIMS once again wrote to Mr. Srimat Emani and the Board of ELIL specifically drawing reference to the corporate guarantee executed by Mr. Sripat Emani on behalf of ELIL, having been authorised by a Board Resolution by Circulation dated 25.09.2006 (Text of the Board Resolution at Annexure). ELIL responded to the same as follows:
  - a. ELIL had not executed any corporate guarantee in favour of RIMS. Admittedly, the Resolution dated 25.09.2006 had been passed by circulation by all the directors of the Company authorizing the execution of a corporate guarantee. However, subsequently, no such director had executed any guarantee as Mr. Sripat had informed the Board that alternative arrangements had been made and the guarantee was no longer necessary.
  - b. On a perusal of the guarantee attached, it is seen that it has been executed by Mr. Sripat Emani. Mr. Sripat Emani was not a director of ELIL on the date of execution of the guarantee. He had been appointed as *additional* director on 01.10 2005. Therefore, at the Annual General Meeting held on 30.09.2006, he had automatically vacated office as director. Hence, as Mr. Sripat was not a director on the date of execution of guarantee, even the Board Resolution dated 25.09.2009 cannot be relied upon by RIMS to bind the company to the guarantee.
  - c. Even assuming that the corporate guarantee had been executed by an authorised official, it being approximately equivalent to INR 10 Million, i.e. exceeding 60 % of the paid-up capital (paid-up capital being INR 16 million) of ELIL, general meeting approval was required for the giving of such a guarantee under Section 372A of the Companies Act, 1956. Since, the same was not obtained, the entire transaction was void and hence, unenforceable.
  - d. Moreover, even the Board Resolution dated 25.09.2006 was only passed by circulation and in view of the mandatory provisions of Section 372A(2), the same was required to have been passed at a meeting of the Board of Directors. Therefore, the Board Resolution was also not valid so as to cast any liability on the company.

12. On 03.01.2009, RIMS filed a suit against ELIL, Srimat, Sripat and Preeti Emani before the District Court of Luxembourg alleging deliberate misrepresentation and fraud in the execution of the corporate guarantee, inducing the bank to part with huge sums of money in favour of ELF Luxembourg. It was further alleged that ELIL was liable under the contract of guarantee as Mr. Sripat Emani had been projected as director of ELIL and was acting under an ostensible authority vested in him by ELIL. Therefore, ELIL could not disclaim its liability under the guarantee.
13. Under the terms of the corporate guarantee, the contract of guarantee was governed by the laws of Luxembourg and the courts at Luxembourg alone had jurisdiction to try any dispute arising out of the guarantee including a dispute relating to the validity or enforceability of the agreement. ELIL, however, did not contest the suit in Luxembourg and remained unrepresented, despite summons.
14. On March 23, 2009, the District Court of Luxembourg held ELIL liable under the contract of guarantee and guilty of breach thereof. Further, the Court, on evidence adduced, was convinced that Mr. Srimat, Sripat and Preeti Emani were guilty of fraud played on the bank, using the company, ELIL as the shield. Based on these findings, an ex parte decree for €160,000 for breach of contract of guarantee was passed against ELIL. Further, additional damages to the tune of €30,000 were awarded against Sripat, Srimat and Preeti Emani for deliberate misrepresentation, fraud and breach of warranty of authority. On the basis of the foreign judgment, this present suit came to be filed before the High Court of Bombay on the basis of the judgment and decree of the courts in Luxembourg.
15. ELIL contended that the foreign judgment could not be enforced in India as against ELIL in view of the provisions of Section 13 of the Code of Civil Procedure, 1908. It put forth the following arguments in its favour:
  - a. The foreign judgment was rendered ex-parte and was not a judgment on merits.
  - b. ELIL was not a party to the contract of guarantee as the contract had been executed by a person who had no authority to act on behalf of ELIL.
  - c. The judgment rendered was perverse and against the laws of India i.e. the provisions of the Companies Act, 1956 and therefore, unenforceable on that ground itself.
  - d. Further, the giving of a guarantee by a person resident in India in favour of a person resident outside India required the permission of the Reserve Bank of India under the terms of the FEMA Guarantees Regulations. Since such approval had not been obtained, the guarantee, if allowed to be enforced, would violate the laws and public policy of India.
16. RIMS, on the other hand, placed the following contentions before the Hon'ble High Court:
  - a. The foreign judgment was a judgment on merits. Further, ELIL had, under the contract of guarantee had submitted to the exclusive jurisdiction of the courts in Luxembourg.
  - b. ELIL was a party to the contract of guarantee as Mr. Sripat Emani, though not a director on the date of execution of the guarantee, was nevertheless a director on the Board at the time of passing of resolution dated 25.09.2006. Therefore, he had ostensible authority on behalf of the company to execute the guarantee on even a subsequent date and hence, could bind the company. The company having held him out to be its director, cannot now turn back to disclaim liability.
  - c. ELIL could not set up the defence of violation of provisions of the Companies Act, 1956 or the FEMA Guarantees Regulations as it was the party at fault and therefore, cannot be permitted to take advantage of its own wrong. In any case, under Clause 3.2 in the Contract of Guarantee, the guarantor had represented that it was authorised to issue the instant guarantee and all necessary regulatory, statutory and other approvals and permissions required in this regard had been obtained. It was on the faith of this representation and warranty that RIMS had entered into the contract of guarantee.

17. You are required to substantiate the allegations of the parties with applicable case laws and statutory provisions and also decide as to what relief the respective parties should pray for. You may vary or add to the arguments of the parties, without altering the essential facts of the case, provided you can substantiate the same with legal provisions.

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ANNEXURE

**EXTRACT OF RESOLUTION PASSED AT THE MEETING OF THE BOARD OF DIRECTORS HELD ON 23.08.2006**

RESOLUTION NO: 23

Mr. Sripat Emani informed the Board that in connection with the proposed incorporation of his company in Europe, financial assistance from the company would be required. It was further informed that he was in the process of finalizing the loan deal with RIMS Bank, Luxembourg, which was insisting on a corporate guarantee from ELIL India. The Board, after discussion, decided to accord in-principle approval to the issue of the guarantee by the company. The terms of the contract of guarantee were presented to the Board and the same were approved as follows:

*“RESOLVED THAT the terms and conditions of the contract of guarantee proposed to be entered into with RIMS Bank have been duly considered and the same, be and are hereby approved.”*

**EXTRACT OF THE RESOLUTION PASSED BY CIRCULATION WITH THE CONSENT OF ALL 7 DIRECTORS ON THE BOARD – (DATE OF RESOLUTION- 25.09.2006)**

It has already been informed to the Board that in connection with the loan transaction to be entered into between ELF Luxembourg and RIMS Bank, a corporate guarantee for an amount of Euros 1,47,500/- is required to be given by the company. The terms of the guarantee have also been approved by resolution no. 23 passed at the Board meeting held on 23.08.2006. In order to expedite the processing of the loan, it is proposed to sanction the issue of a corporate guarantee in favour of RIMS Bank. Accordingly, the following resolution is passed:

*“RESOLVED THAT, in view of the request from RIMS Bank to ELF Luxembourg to secure a corporate guarantee from the company, it is hereby authorised that the guarantee whose terms have been approved at the Board Meeting held on 23.08.2006, be issued in favour of RIMS.*

*FURTHER RESOLVED THAT any director of the company be and is hereby authorised to execute the guarantee on behalf of the company.”*

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