

(1976) 08 KL CK 0003

In the High Court Of Kerala

Case No : C.C. No's. 351 and 352 of 1975 (in C.P. No. 3 of 1973) , C.S. No. 10 of 1975 (in C.P. No. 12 of 1971) etc.

Gokul Chit Funds and Trades Private Ltd.

APPELLANT

Vs

Thoundasseri Kochu Ouseph Vareed and Others

RESPONDENT

Date of Decision : 25-08-1976

Acts Referred:

Kerala Chitties Act, 1975 — Section 39, 70
Kerala Insolvency Act, 1956 — Section 47

Citation : AIR 1977 Ker 68

Hon'ble Judges : V. Balakrishna Eradi, J;G. Viswanatha Iyer, J

Bench : Division Bench

Judgement

Balakrishna Eradi, J.—These are claims brought by the Official Liquidator u/s 446 read with Section 458-A of the Companies Act, 1956 (hereinafter referred to as the Act). The Companies in liquidation in all these cases were engaged in the business of conducting chit funds. The respondents who had joined as subscribers in some of the chits conducted by these Companies had been allowed to draw the amounts due on prized tickets in some of the chit fund series against promissory notes or mortgage bonds executed by them to secure due payment of the future instalments. Before all the instalments in these chits had become due or were paid the Companies went into liquidation. In the course of the winding-up proceedings the Official Liquidator has preferred these claims against the respondents for recovery of the balances due from them under the prized chit accounts. The main contention put forward by the respondents is that they are entitled to a set-off in respect of amounts paid by them to the concerned Companies either by way of term deposits or by way of subscriptions (instalments) to other chits in which also they had joined and which had not been prized. In view of the importance of the common question of law relating to the right of set-off involved in these cases the learned single Judge, before whom the matter came up in the first instance, considered it desirable that the said question should be decided by a Division Bench. Accordingly these cases have

come up before us.

2. The course that we propose to adopt is to consider and decide only the question of law arising out of the plea for set-off put forward by the respondents and to leave the remaining questions to be dealt with by the learned single Judge. Hence it is unnecessary for us to set out in detail the facts pertaining to each of these cases and it would suffice to say that in relation to the plea for set off these cases can be classified into three different categories. The first category consists of cases where the claim made against the concerned respondents is for recovery of the instalments outstanding as due in respect of a prized ticket and the respondent seeks to set-off the amounts paid by him to the concerned Company by way of subscription in an unprized chit which he has joined in the same chit fund series. The second category consists of cases where in defence to the claim for recovery of the amount due by way of instalments on a prized ticket belonging to one particular chit fund series, the respondent seeks to set-off amounts paid by him to the Company by way of subscriptions in the account of an unprized chit of a different series, In the third category fall a few cases where a prized subscriber from whom the amount of unpaid instalments is claimed by the liquidator seeks a set-off in respect of amounts which he had deposited with the Company under liquidation by way of term deposits.

3. Section 529 of the Act provides that "in the winding-up of an insolvent company, the same rules shall prevail and be observed with regard to (a) debts provable; (b) the valuation of annuities and future and contingent liabilities; and (c) the respective rights of secured and unsecured creditors; as are in force for the time being under the law of insolvency with respect to the estates of persons adjudged insolvent", The law of insolvency in force in this State is the Insolvency Act, 1955 (Act 2 of 1956) as amended by (Act 18 of 1957). Section 47 of that Act, which is identical in terms with Section 46 of the Provincial Insolvency Act, 1920, (Act 5 of 1920) reads:

"Mutual dealings and set off:--Where there have been mutual dealings between an insolvent and a creditor proving or claiming to prove a debt under this Act, an account shall be taken of what is due from the one party to the other in respect of such mutual dealings, and the sum due from the one party shall be set off against any sum due from the other party, and the balance of the account and no more, shall be claimed or paid on either side respectively."

The respondents contend that by virtue of the above provision they are entitled to set-off against the debts claimed by the Liquidator the amounts due to them from the Company under liquidation either on account of subscriptions paid towards other unprized chits in the same series or in different series, or on account of fixed deposits made by them with the Company. This contention is strongly opposed by the Official Liquidator. According to the Liquidator the amount due to the foreman from a prized subscriber is a fund impressed with the character of a trust and the said fund cannot be utilised by the foreman for any purpose other than for payment to the unprized subscribers of that particular

kuri, It is said that the unpriized subscribers of a particular kuri have a lien on the fund consisting of the amounts due to the foreman from the unpriized subscribers of that particular kuri and that where such a lien exists in favour of third parties the provisions of Section 47 can have no application. In support of this contention strong reliance was placed by the Liquidator on the decision of Raman Nayar, J., as he then was, in *In Re: Free India Bank Ltd. (in liquidation)*, wherein the learned Judge has expressed, the view that the effect of Section 42 of the Travancore Chitties Act is to create a charge on the assets of the chitty in favour of the chitty creditors and that since the money due from the prized subscribers to the Company is a chitty asset on which the said charge operates, the chitty debtors, viz., the prized subscribers are not entitled to have any other amounts due to them from the Company as ordinary creditors set-off against the money due from them to the chitty. It is contended by the Liquidator that even though the provision contained in Section 42 of the Chitties Act (Travancore Act 26 of 1120) has no application in these cases which have arisen from the Malabar area, the Kerala Chitties Act, 1975 which is in force in all parts of this State contains a similar provision in Section 39 of that enactment. It is further urged by the Liquidator that even though the Kerala Chitties Act was brought into force only with effect from the 25th July, 1975, by Section 70 of that Act all the provisions of the said Act other than those contained in Sections 3, 4, 8, 9 and 15 are made applicable to the chitties started before the commencement of the said Act in the Malabar area. It is on this basis that the Official Liquidator contends that the principle laid down by Raman Nayar, J. in *In Re: Free India Bank Ltd. (in liquidation)*, is applicable to the present cases and that hence set-off cannot be allowed.

4. We shall first deal with the contention put forward by the Liquidator based on Section 70 of the Kerala Chit-ties Act, 1975. That section reads:

"70, Application of Act to certain existing chitties.-- The provisions of this Act save those contained in Section 3, Section 4, Section 8, Section 9 and Section 15 shall, so far as may be, apply to chitties started before the commencement of this Act in the Mala-bar District referred to in sub-section (2) of Section 5 of the States Reorganisation Act, 1956 (Central Act 37 of 1956)".

The Liquidator wants us to understand this section as laying down that all the provisions of the Kerala Chitties Act, 1975 other than those specifically excepted shall be applicable in the matter of determination of the rights and liabilities of parties arising out of all chit fund transactions which were started in the Malabar area prior to the date of commencement of the said Act irrespective of whether or not the chit fund scheme was in existence on the said date. According to, the Liquidator the effect of Section 70 is to make the provisions of the 1975 Act applicable even in respect of claims or disputes arising out of chit fund transactions which had ceased to exist long prior to the commencement of that Act, whether such cessation be due to the natural termination of the normal period of duration fixed for the kuri, or due to any default or abandonment by

the foreman or the liquidation of the foreman Company, We are unable to uphold this contention put forward by the Liquidator. An examination of the provisions of the Kerala Chitties Act unmistakably shows that their underlying purpose is to regulate and control the conduct of chitties in the State in order to effectively check and prevent various types of irregularities and malpractices in relation to the conduct of such transactions and thereby safeguard the interests of the members of the public subscribing to the chit fund schemes. The object of Section 70 of the said Act as we see it, is to enable such effective check and control being exercised even in respect of chit fund transactions which were started in the Malabar area prior to the commencement of the Act and which were in existence on the date of such commencement. Any ambiguity or doubt that might have otherwise existed in regard to this matter is effectively dispelled by the wording used in the heading of the section which clearly indicates that the applicability of the section is confined to "existing chitties" started before the commencement of the Kerala Chitties Act. The heading given to the section "being part of the enacted legislation it can be referred to as a useful aid for resolving any ambiguity or doubt regarding the intention of the legislature. The expression "existing chitties" used in the heading to Section 70 unmistakably indicates that the intention of the legislature was only to apply the provisions of the 1975 Act to such of the chitties started in the Malabar area prior to the date of commencement of that Act which were actually in existence as live-chit fund transactions on that date. Hence we have no hesitation to hold that Section 70 of the Kerala Chitties Act, 1975 does not have the effect of rendering the provisions of the said enactment applicable in the matter of determination of the rights and liabilities of parties in respect of chit fund transactions in the Malabar area which were not in existence on the date of commencement of the said Act. The contention put forward by the Liquidator that Section 39 of the Kerala Chitties Act applies to these cases by virtue of Section 70 of the said Act cannot, therefore, be accepted,

5. We may also observe that even If it is to be assumed for purposes of discussion that Section 39 of the Kerala Chitties Act, 1975, which corresponds to Section 42 of the Chitties Act--26 of 1120 (Travancore)--is applicable to these cases we find nothing in that section which will adversely affect the benefit, if any, that the respondents may be entitled to claim under the provisions of Section 47 of the Insolvency Act, 1955. With great respect, we are unable to agree with the view expressed by Eaman Nayar, J. in In Re: Free India Bank Ltd. (in liquidation), , that the effect of Section 42 of the Chit-ties Act (Travancore) was to create a charge in favour of the chitty creditors over the monies due to the chitty from the prized subscribers. Section 39 of the Kerala Chitties Act, which is identical in terms with Section 42 of the Travancore Chitties Act, 1120 reads as follows:

"39. Preference of subscribers over chitty assets.-- Where there are debts due from the foreman of a chitty in relation thereto and also other debts due from such foreman, the chitty assets shall be a first charge for payment of the chitty

debts due to the subscribers."

In our opinion what has been done by the section is only to lay down a rule of preference in the matter of utilisation of the chitty assets for payment of the debts due from the foreman of a chitty by providing that chitty debts to the subscribers shall have preference over other debts. Though the language used in the section lacks clarity and precision and the use of the expression "first charge" does create a certain amount of confusion, it seems to us clear on a careful examination of the section that what the legislature has intended is only to provide for a preferential payment to the chitty creditors. The heading given to the section, viz.. "Preference of subscribers over chitty assets" also indicates that the intention was not to create a charge over the chitty assets but only to lay down a rule of preference as between creditors. If the intention was to create a charge over the chitty assets the language of the section ought to have been that the chitty debts due from the foreman of a chitty to the subscribers shall be the first charge on the assets. Significantly that is not what is stated by the section. Instead, the language used by the legislature is that the chitty assets shall be a first charge for payment of the chitty debts. These words, in our opinion, can, in the context, be only construed as meaning that the chitty debts due to the subscribers shall have preference over other debts in the matter of payment from out of the chitty assets. Hence we are unable to accept the contention that Section 39 creates a charge over the chitty debts in favour of third parties, namely the unprized subscribers of the particular kuri and that hence there cannot be any set-off in respect of such debts.

6. That brings us to the question whether the respondents are entitled to the benefit of set-off u/s 47 of the Insolvency Act, 1955. This section corresponds verbatim to Section 46 of the Provincial Insolvency Act, 1920 which, in turn, is modelled on Section 31 of the (English) Bankruptcy Act, 1914. The said provision embodies a rule of equity and its intention is to prevent the great injustice which would arise if a person who is the insolvent's creditor on one account and is a debtor of the insolvent on some other account is compelled to pay in full the amount owed by him to the insolvent and is left to prove in bankruptcy the debt due to him from the insolvent and to receive only such pro-rata dividend as he could get on it. In England, long before the making of any statutory provision on the subject it was the practice in bankruptcy where there was a debtor and creditor account between the bankrupt and another person to take the account between them and adjust the balance due from the one party to the other. Such equitable set-off was not however being allowed when the debts were unconnected as in case where they arose out of distinct transactions. This led to great injustice and it was to remedy the said situation that statute intervened in England as far back as the reign of Queen Anne by 4 and 5 Anne, c. 17 by introducing a mandatory principle of set-off in bankruptcy proceedings in respect of mutual debts. Subsequently that principle was widened and developed in the late statutes so as to extend the right of set-off in bankruptcy proceedings to all cases where there have been mutual credits, mutual debts or other mutual

dealings, between a debtor against whom a receiving order is made and any other person proving or claiming to prove a debt under the receiving order-- see Section 31 of the Bankruptcy Act, 1914. The expression "mutual dealings" has been construed by the English courts as a term of wide import. The provisions for set-off incorporated in the insolvency statutes of this country are modelled on the section contained in the English Bankruptcy Act. As already noticed, the statutory provision for set-off in bankruptcy was originally introduced in England was narrow in its content but by successive statutes the principle was developed and widened. The last step in that process of enlarging the scope of the section was taken in 1869 when the expression "mutual dealings" was also added in the section--Section 39 of the Bankruptcy Act, 1869--thereby bringing within the scope" of the principle of set-off all provable claims provided there is mutuality. It is significant that the Indian legislature while enacting Section 47 of the Presidency-Towns Insolvency Act, 1909 (Act 3 of 1909) as well as Section 46 of the Provincial Insolvency Act, 1920 (Act 5 of 1920) omitted the words "mutual credits" and "mutual debts" occurring in the English statute and has used only the comprehensive expression "mutual dealings", thereby clearly indicating the intention to apply to this country the principle of set-off in its widest form as it obtains in the English Bankruptcy jurisdiction after the words "mutual dealings" were added in the English statute in 1869. The said principle is attracted in all cases where as between the insolvent and a creditor proving or claiming to prove his debt under the Act there have been mutual dealings which have given rise to mutual claims resulting in pecuniary liabilities on either side. As already noticed, the expression "mutual dealings" is very wide in its content. Broadly stated, it connotes transactions effected between the same parties, functioning in the same right or capacity giving rise to reciprocal claims or demands which are provable in insolvency proceedings. As pointed out by Lord Russell in *Palmer v. Day & Sons* (1395) 2 QB 618, while the right of set-off conferred by the section is undoubtedly very wide it is subject to the limitation that "the "dealings" must be such that in the result the account contemplated in the section can be taken in the way therein described. In other words, the dealings must be such as will end on each side in a money claim". Thus a person in custody of goods belonging to the insolvent against whom a claim is brought for recovery of the goods in species is not entitled to set off against the said claim any debt that may "be due to him from the insolvent. That is because there cannot be an "account" as between goods and money and no, "balance can be struck--see *Eberle's Hotels and Restaurant Co. Ltd. v. E. Jones & Brothers* (1887) 18 QBD 459, *Palmer v. Day & Sons* Ibid, *Rolls Razor Ltd. v. Cox* (1967) 1 All ER 397. Thus the conditions for availability of the right of set-off conferred by the section are that the claims on each side should be such as result in pecuniary liabilities arising out of contract and the dealings which have given rise to those claims should have been between the same parties functioning in the same capacity or right. Set-off is allowable under the section not only where both the debts in question are immediately payable but also in cases where as against a demand presently payable there is due to the other party a debt payable at a future date. The

benefit of the section extends also to cases where a person who owes a debt to another has a claim against that other person in respect of damages where liquidated or unliquidated, arising out of contract-- see *Peat v. Jones* (1881) 8 QBD 147, *Jack v. Kipping* (1882) 9 QBD 113, *Palmer v. Day & Sons* (1895) 2 QB 618 and *Krishna Chandra Bhounick Vs. Pabna Dhanabhandar Co. Ltd.*, .

7. The only condition specified in Section 47 of the Insolvency Act, 1955 for attracting its applicability is that there should have been "mutual dealings" between the insolvent and the person claiming the benefit of set-off and the reciprocal claims should have arisen out of such mutual dealings. The "mutual dealings" referred to in the section may consist of several distinct or independent transactions entered into between the same parties functioning in the same right or capacity. It is not, therefore, necessary that the debts or claims sought to be set-off against each other should have arisen out of one and the same transaction. As observed by Montague Smith, J. in the leading case *Naoroji v. Chartered Bank of India*, (1868) 3 CP 444 , "to bring a case within the Act, it is not necessary that the credits should be dependent the one upon the other, nor that there should have been any agreement beforehand". Thus it has been held that where a surety who is under an obligation to pay to the insolvent company the debts of another person has some money owing to himself from the insolvent company in a totally separate transaction the monies due to the surety on the one hand and from him to the insolvent company on the other are "mutual dealings" as contemplated by Section 47 and the two amounts can be set off against each other under the section. See *D. Sundaravaradan Vs. R. Narasimhachari*, Official Liquidator, and also *Ex Parte Stephens*. (1805) 32 ER 996. It is also settled law that the existence of a security will not affect the statutory right of set-off conferred by the section. The mandate of the statute is to effect a set-off irrespective of the existence or otherwise of any security and to arrive at the recoverable residue, if any, by a process of mutual deduction-- see *EX parte Barnett*. In *re Deveze* (1674) 9 Ch A 293 and *Issac Issac Poranganal House Vs. Palai Central Bank Ltd.*, . It is equally well-established that the right, and duty, to set-off under this section being statutory cannot be excluded by agreement. As Lord Selborne said in *Mersey Steel and Iron Co. (Limited) v. Naylor, Benzon & Co* (1884) 9 AC 438, "it is a positive, absolute rule for the purpose of proof in bankruptcy, and nothing can be proved according to that rule in such cases except the balance of the account."

8. The legal position being as stated above, we do not find it possible to uphold the stand taken by the Liquidator that set-off cannot be allowed in respect of the amounts due to the respondents from the insolvent Company concerned either by way of repayment of their term deposits or on account of subscriptions paid by the respondents to other non-prized kuries conducted by the respective Companies, As observed already, in order to constitute "mutual dealings" within the meaning of Section 47 of the Insolvency Act, 1955 what is required is only that the transactions which have given rise to the reciprocal claims or demands should be between the same parties contracting or acting in the same right or

capacity. In accepting the term deposits and also in receiving the subscriptions towards the unprized chits from the respondents the insolvent Companies were functioning in the very same right and capacity in which they had advanced to the respondents the amounts due to them on their prized tickets. The Companies were conducting chit fund business and it is in the course of that business that term deposits were being received from the chit subscribers. The different series of" chit funds were conducted by the respective Companies in one and the same capacity, namely that of the foreman conducting chitty transactions, and it was in that capacity that the Company advanced the chit amounts to the prized subscribers, received the subscriptions from the prized as well as unprized subscribers and also accepted the term deposits. All these dealings had been effected by the Companies in the same right or capacity. The respondents had carried on the transactions with the Companies only in their individual or personal capacity and they had functioned only in the same capacity or right in relation to all the distinct or separate dealings that they may have had with the Companies.

9. It is contended by the Liquidator that each particular kuri is a distinct and self-contained transaction which is unrelated to the other kuries conducted by the same foreman and that hence persons who may have become subscribers in more than one kuri are not entitled to adjust their liabilities in respect of a particular kuri as against any amounts that may be due to them from the foreman in the account of another kuri. Whatever may be the tenability or otherwise of this contention in other contexts when insolvency of the foreman has not supervened, the proposition cannot hold good in winding-up proceedings in view of the absolute provision contained in Section 47 of the Insolvency Act that in all cases where as a result of mutual dealings reciprocal demands or claimed have arisen between the parties a set-off shall be allowed irrespective of whether those demands have arisen out of the same transaction or out of different transactions entered into between the same parties. The principle laid down by the section is absolute in its terms and has therefore, to be mandatorily given effect to even if there was any express stipulation in the content or implied understanding between the parties that the rights and liabilities arising out of the different chit fund transactions are not to be adjusted against each other.

10. As regards the first category of cases where in defence to the liquidator's claim for recovery of the balance amounts outstanding as due from the respondents by way of subscriptions on their prized tickets the respondents have sought a set-off" in respect of the amounts paid by them to the concerned companies by way of subscriptions on unprized tickets taken by them in the very same kuri, it was not seriously argued by the Liquidator that they are not reciprocal demands arising out of "mutual dealings" falling within the scope of Section 47 of the Insolvency Act, 1955. A set-off is clearly allowable to the respondents in these cases. It was in respect of the remaining two categories of cases, namely where the set-off is claimed by the respondents in respect of amounts due to them from the concerned Companies either on account of

subscriptions paid by them towards unprized tickets in other kuries conducted by the same Companies or on account of term deposits made with them with the concerned Companies that the Liquidator strongly opposed the prayer for set-off on the ground that they are not mutual dealings. For the reasons indicated by us In the course of the preceding discussion it is manifest that this contention put forward by the Liquidator cannot be sustained. We hold that the respondents are entitled to a set-off" in all the three categories of cases mentioned above.

11. In *Official Liquidator v. Smt. B. Lakshmikutty* 1075 TaxLR 1949 (Kant), a learned single Judge of the Karnataka High Court recently had occasion to consider an almost identical question. In that case also certain Companies which were carrying on chit fund business went into liquidation and claims were filed by the Official Liquidator against the prized subscribers for the recovery of the balance amounts due from them under the respective chit fund accounts. The respondents contended inter alia that they were entitled to a set-off to the extent of the sums paid by them to the concerned Companies under other chit fund accounts or by way of fixed deposits. This contention was upheld by the learned Judge and it was held that the respondents were liable to pay only the balances remaining after giving credit to the sums in respect of which set-off was pleaded. This decision fully supports the conclusions that we have reached in these cases and with respect we are in complete agreement with the reasoning contained therein,

12. The cases will now go back to the learned single Judge for disposal on the merits in the light of the legal position as explained above. We do not make any order as to costs in respect of the hearing before us.