

(1994) 10 GUJ CK 0005
In the Gujarat High Court
Case No : Appeal No. 16 of 1991

Gujarat State Financial Corporation

APPELLANT

Vs

Official Liquidator and Others

RESPONDENT

Date of Decision : 07-10-1994

Acts Referred:

Companies Act, 1956 — Section 171, 229, 231, 232, 391

Sick Industrial Companies (Special Provisions) Act, 1985 — Section 15, 22, 22(1), 25

Citation : (1996) 87 CompCas 658

Hon'ble Judges : Rajesh Balia, J;A.P. Ravani, J

Bench : Division Bench

Judgement

Rajesh Balia, J.—This appeal arises out of the order passed by the learned company judge in Company Application No. 36 of 1990 in Company Petition No. 28 of 1986 on February 2, 1991. It has arisen in the following circumstances.

2. The order for winding up of Himalaya Tools Pvt. Ltd. was passed and respondent No. 1, official liquidator, was appointed on April 25, 1988. The official liquidator wrote a letter dated May 4, 1988, informing that he will take physical possession of the properties of the company on May 13, 1988. The public notice informing about the winding up order of the company was also published in the Times of India, dated May 8, 1988. The Gujarat State Financial Corporation (hereinafter called "the Corporation") and the Bank of Maharashtra are secured creditors of the company. The property in question, which included plant and machinery of the company was hypothecated and/or mortgaged with the Corporation. The Corporation exercised its powers u/s 29 of the State Financial Corporations Act, 1951, and took possession of the assets of the company hypothecated/mortgaged with it allegedly on May 9, 1988. The plant and machinery, possession of which was taken over by the Corporation was transferred to Mahuvawala Trading Company, Bombay, for a sum of Rs. 8,99,786.57 and possession was handed over to the purchaser on December 20, 1989. The official liquidator moved the company court by an application making a prayer that the respondent-Corporation be directed to hand over possession of

Himalaya Tools Pvt. Ltd. to the applicant immediately.

3. It was contended on behalf of the applicant that once an order for winding up of the company has been passed and the official liquidator is appointed to take charge of the properties of the company, the assets of the company are deemed to be in the custody of the court as from the date of the order of winding up of the company and no person including the secured creditor has a right to take possession of the property from the custody of the court except with the leave of the court. Only the court can deal with and disburse the assets of the company as per the provisions of the Companies Act after determining the dues of the creditors. It was also contended that before taking possession u/s 29 of the State Financial Corporations Act and realising the security by sale, the Corporation was under an obligation to seek leave of the company court in terms of section 446 of the Companies Act and the transfer effected without leave of the company court is void in terms of section 537 of the Companies Act, 1956.

4. On behalf of the Corporation, it was contended that the Corporation is a secured creditor of the company in winding up; and in view of the provisions of section 529 of the Companies Act read with section 28 of the Provincial Insolvency Act, 1920, it is outside the proceedings of the winding up. Exercise of its right to realise the security does not come within the purview of section 446 so as to require the leave of the court before taking action u/s 29 of the State Financial Corporations Act. It was contended that as section 29, which is a provision in tune with section 69 of the Transfer of Property Act, empowers a secured creditor, namely, the Corporation to realise the security without intervention of the court, the exercise of the power u/s 29 of the State Financial Corporations Act is not akin to proceedings in a suit in the court nor is it "other legal proceedings" within the meaning of section 446 of the Companies Act. Hence, the restrictions u/s 446 are not applicable.

5. The learned company judge after detailed discussion reached the following conclusion and allowed the application filed by the official liquidator in the following terms :

"Hence this application is required to be allowed and is hereby allowed. However, considering the facts that the Gujarat State Financial Corporation had sold the plant and machinery of the company under liquidation and possession of the plant and machinery is handed over to the purchaser on December 20, 1989, by recovering the entire sale consideration of Rs. 8,99,86.52 and that there is no allegation that the said transaction was not a genuine one or was in any way collusive, the prayer for taking possession of the said plant and machinery from the purchaser is not granted. So far as the workmen's dues are concerned, the official liquidator is directed to file a separate application for proper distribution as per the Companies Act. The Corporation is directed to hand over possession of the assets of the company under liquidation to the official liquidator within fifteen days from today. The Corporation is also directed to deposit the amount of Rs. 8,99,786.52 received by it by sale of plant and machinery of the company under

liquidation with the official liquidator within fifteen days from today. In the facts and circumstances of the case, there shall be no order as to costs".

Aggrieved with the aforesaid order, the Corporation has preferred this appeal.

6. Mr. B.R. Shah, learned counsel appearing for the Corporation, contended that the law is firmly established that the secured creditor is outside the winding up and he can realise his security without intervention of the court by effecting sale of the mortgaged property by private or public sale. Leave of the court is necessary only when intervention of the court is sought for realising the security. He placed reliance for this proposition on the case of *M.K. Ranganathan and Another Vs. Government of Madras and Others*, . It was also urged by learned counsel that though the aforesaid decision was rendered with reference to the provisions contained in sections 171, 229, 232 of the Companies Act, 1913, the corresponding provisions of sections 446, 529 and 537 of the Companies Act, 1956 are *pari materia* with the earlier Act and the position of law has not changed. He also placed reliance on an unreported decision of the Karnataka High Court in O.S.A. No. 26 of 1991 in Company Application No. 218 of 1991 in Company Petition No. 131 of 1988. *Commissioner of Income Tax Vs. M.S.P. Rajes*, decided on January 23, 1992.

7. Mr. Soparkar, learned counsel appearing as *amicus curiae* for the official liquidator, urged that the principle laid down in the aforesaid decision cannot be made applicable now in view of the amendments made in section 529 and insertion of section 529A of the Companies Act, vide Act No. 35 of 1985. It was not disputed that prior to the aforesaid amendment, which resulted in creation of a *pari passu* charge on the security of the secured creditors in favour of the workmen to the extent of the workmen's portion in the security, the position of the secured creditor under the Companies Act, 1956, remained the same as it was in 1913 Act. He placed reliance on the case of *Maharashtra State Financial Corporation, Bombay Vs. Ballarpur Industries Limited, v. The Official Liquidator*, High Court Bombay and *Liquidator of M/s. Atrois Chemicals Private Limited, , K. Sp. V. Shanmugam Vs. Maharashtra State Co-operative Cotton Growers Marketing Federation Ltd. and another, and Kerala Financial Corporation v. Official Liquidator* [1991] 71 Comp Cas 324 (Ker).

The question, therefore, arises is, what is the effect of the insertion of the proviso to sections 529(1) and 529A in the Companies Act, 1956, by Act No. 56 of 1985 on the status of the secured creditor as it existed heretobefore.

8. It will be appropriate here to refer to the relevant provisions of the Act. Sections 446, 456(2), 529(1), (2), 529A and 537 of the Act read as under :

"446. Suits stayed on winding up order. - (1) 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 winding up order, shall be proceeded with, against the company, except by leave of the court and subject to such terms as the court may impose.

(2) The court which is winding up the company shall, notwithstanding anything contained in any other law for the time being in force, have jurisdiction to entertain, or dispose of -

(a) any suit or proceeding by or against the company;

(b) any claim made by or against the company (including claims by or against any of its branches in India);

(c) any application made u/s 391 by or in respect of the company;

(d) any question of priorities or any other question whatsoever, whether of law or fact, which may relate to or arise in course of the winding up of the company;

whether such suit or proceeding has been instituted, or is instituted, or such claim or question has arisen or arises or such application has been made or is made before or after the order for the winding up of the company, or before or after the commencement of the Companies (Amendment) Act, 1960.

(3) Any suit or proceeding by or against the company which is pending in any court other than that in which the winding up of the company is proceeding may, notwithstanding anything contained in any other law for the time being in force, be transferred to and disposed of by that court.

(4) Nothing in sub-section (1) or sub-section (3) shall apply to any proceeding pending in appeal before the Supreme Court or a High Court."

"456(2). Custody of company's property. - . . .

(2) All the property and effects of the company shall be deemed to be in the custody of the court as from the date of the order for the winding up of the company."

"529(1). Application of insolvency rules in winding up of insolvent Companies. -

(1) 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 :

Provided that the security of every secured creditor shall be deemed to be subject to a pari passu charge in favour of the workmen to the extent of the workmen's portion therein, and, where a secured creditor, instead of relinquishing his security and providing his debt, opts to realise his security, -

(a) the liquidator shall be entitled to represent the workmen and enforce such charge;

(b) any amount realised by the liquidator by way of enforcement of such charge shall be applied rateably for the discharge of the workmen's dues; and

(c) so much of the debt due to such secured creditor as could not be realised by him by virtue of the foregoing provisions of this proviso or the amount of the workmen's portion in his security, whichever is less, shall rank *pari passu* with the workmen's dues for the purposes of section 529A.

(2) All persons who in any such case would be entitled to prove for and receive dividends out of the assets of the company, may come in under the winding up, and make such claims against the company as they respectively are entitled to make by virtue of this section :

Provided that if a secured creditor instead of relinquishing his security and proving for his debt proceeds to realise his security, he shall be liable to (pay his portion of the expenses) incurred by the liquidator (including a provisional liquidator, if any) for the preservation of the security before its realisation by the secured creditor.

Explanation. - For the purposes of this proviso, the portion of expenses incurred by the liquidator for the preservation of a security which the secured creditor shall be liable to pay shall be the whole of the expenses less an amount which bears to such expenses the same proportion as the workmen's portion in relation to the security bears to the value of the security."

"529A. Overriding preferential payments. - (1) Notwithstanding anything contained in any other provision of this Act or any other law for the time being in force, in the winding up of a company -

(a) workmen's dues; and

(b) debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to sub-section (1) of section 529 *pari passu* with such dues;

shall be paid in priority to all other debts.

(2) The debts payable under clause (a) and clause (b) of sub-section (1) shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions."

"537. Avoidance of certain attachments, executions, etc., in winding up by or subject to supervision of court. - (1) Where any company is being wound up by or subject to the supervision of the court -

(a) any attachment, distress or execution put in force, without leave of the court, against the estate or effects of the company, after the commencement of the winding up; or

(b) any sale held, without leave of the court, of any of the properties or effects of the company after such commencement;

shall be void.

(2) Nothing in this section applies to any proceedings for the recovery of any tax or impost or any dues payable to the Government."

9. As section 529(1)(c) specifically makes the rule for the time being in force under the law of insolvency with respect to the estate of the person insolvent with regard to the respective rights of the secured and unsecured creditors applicable to winding up proceedings, it will also be relevant to refer to the relevant part of section 28 of the Provincial Insolvency Act which is applicable to the State of Gujarat.

"28. ... (2) On the making of an order of adjudication, the whole of the property of the insolvent shall vest in the court or in a receiver as hereinafter provided, and shall become divisible among the creditors, and, thereafter, except as provided by this Act, no creditor to whom the insolvent is indebted in respect of any debt provable under this Act shall during the pendency of the insolvency proceedings have any remedy against the property of the insolvent in respect of the debt, or commence any suit or other legal proceeding, except with the leave of the court and on such terms as the court may impose...

(6) Nothing in this section shall affect the power of any secured creditor to realise or otherwise deal with his security, in the same manner as he would have been entitled to realise or deal with it if this section had not been passed..."

Section 47 of the said Act reads as under :

"47. (1) Where a secured creditor realises his security, he may prove for the balance due to him, after deducting the net amount realised.

(2) Where a secured creditor relinquishes his security for the general benefit of the creditors, he may prove for his whole debt.

(3) Where a secured creditor does not either realise or relinquish his security, he shall, before being entitled to have his debt entered in the schedule, state in his proof the particulars of his security, and the value at which he assesses it, and shall be entitled to receive a dividend only in respect of the balance due to him after deducting the value so assessed.

(4) Where a security is so valued, the court may at any time before realisation redeem it on payment to the creditor of the assessed value.

(5) Where a creditor, after having valued his security, subsequently realises it, the net amount realised shall be substituted for the amount of any valuation previously made by the creditor, and shall be treated in all respects as an amended valuation made by the creditor.

(6) Where a secured creditor does not comply with the provisions of this section, he shall be excluded from all share in any dividend."

It may be seen that in section 446(1), it has been envisaged that where winding

up order has been made or official liquidator has been appointed as provisional liquidator, no suit or "other legal proceedings" shall be commenced or if pending at the date of winding up order, can be proceeded with against the company except by the leave of the court and subject to the conditions as the court may impose. This provisions by itself does not leave the secured creditor out of its net if he has to commence or proceed with a suit or other legal proceeding. However, u/s 529, the rules applicable to rights of secured creditors, with respect to the estate of persons insolvent, as are available under the relevant insolvency law, are made applicable to the winding up proceedings of an insolvent company, that is, where the winding up is for failure of the company to pay its debts. Hence, the restriction imposed by section 446 has to be read in light of section 28 of the Provincial Insolvency Act. Sub-section (6) of section 28 clearly postulates that while under sub-section (2) of the said provision, on the making of an order of adjudication, the whole property of the insolvent vests in the court or in the receiver and no creditor of the insolvent shall have any remedy against the property of the insolvent in respect of the debt and he has to be precluded from commencing any suit or other legal proceedings except with the leave of the court, under sub-section (6), the right given to the secured creditor to realise or otherwise deal with the security has been kept outside the insolvency proceedings by declaring that his power remained unaffected as if this section had not been passed. That is to say, the other provision of the section which declares vesting of the property in the court on an order of adjudication and debarring other remedies of the creditor without leave of the court do not come into operation as if the said provision does not exist qua the power of realisation of the security by the secured creditor.

10. It is only by reading the provisions of corresponding section 171 of the Companies Act, 1913, which is corresponding to section 446(1) of the Companies Act, 1956, in conjunction with section 229 of the 1913 Act which is corresponding to section 529 of the Act of 1956 that their Lordships of the Supreme Court came to the conclusion in Ranganathan's case [1955] 25 Comp Cas 344 as under :

"The secured creditor is thus outside the winding up and can realise his security without the leave of the winding up court, though if he files a suit or takes other legal proceedings for the realisation of his security, he is bound u/s 231 (corresponding to section 171, Indian Companies Act) to obtain the leave of the winding up court before he can do so although such leave would almost automatically be granted."

11. The principle on which this conclusion was founded was that it is the right of the mortgagee to secure realisation of his monies by sale of mortgaged property, to the extent, a mortgage right vests in the mortgagee. Such right is his property and on an adjudication, the property of the mortgagee does not vest in the court or the official liquidator. What is vested in the court is the property of the insolvent. In the case of an insolvent company, the same principle applies, albeit

no vesting of the property in the court take place, but only custody is deemed to be with the court. Their Lordships of the Supreme Court quoted with approval the principle enunciated by Lord Wrenbury in *Food Controller v. Cork* [1923] AC 647, wherein he stated as under (page 670) :

"The phrase "outside the winding up" is an intelligible phrase if used, as it often is, with reference to a secured creditor, say a mortgagee. The mortgagee of a company in liquidation is in a position to say "the mortgaged property is to the extent of the mortgage my property. It is immaterial to me whether my mortgagor is in winding up or not. I remain outside the "winding up" and shall enforce my rights as mortgagee." This is to be contrasted with the case in which such a creditor prefers to assert his right, not as a mortgagee, but as a creditor. He may say "I will prove in respect of my debt". If so, he comes into the winding up."

12. The proposition that when a mortgagee sells the mortgaged property, he is selling not the mortgagor's but his own property, appears to be firmly established in English law. Buckley in his *Treatise on the Companies Acts*, has summarised the position as under :

"Sale by mortgagee : A sale by a mortgagee in exercise of his power of sale is not a disposition of the property of the company within this section. The mortgaged property was disposed of by the company when it executed the mortgage. When the mortgagee sells, he is selling, not the company's, but his own property."

Again, at page 580, it has been stated as under :

"The mortgagee is independent of the winding up proceedings, and his action is to enforce a claim, not against the company, but to his own property."

13. This principle is culled out from a series of the Chancery Division pronouncements. Reference in this connection may be made to *David Lloyd and Co., In re : Lloyd v. David Lloyd and Co.* [1877] 6 Ch 339; *Campbell v. Compagnie Generale de Bellegarde* [1876] 2 Ch 181; *Henry Pound Son and Hutchins, In re* [1889] 42 Ch 402; *West Cumberland Iron and Steel Co., In re* [1893] 1 Ch 713; distinguish *Brown, Bayley and Dixon ex parte Roberts and Wright, In re* [1881] 18 Ch 469. The same principle has been quoted with approval by their Lordships of the Supreme Court in *M.K. Ranganathan's case* [1955] 25 Comp Cas 344 referred to above which makes it clear that the secured creditor is ordinarily outside the winding up proceedings in the matter of realising his security, where intervention of the court is not sought as a result of the provisions of section 529(1) read with section 28(6) of the Provincial Insolvency Act which is on the principle that the secured creditor in realising its security without intervention of the court is not enforcing any claim against property of the insolvent but is going to enforce the claim to his own property. This conclusion is further fortified by insertion of the proviso to section 529(2) in 1960 which requires that all debts may come under the winding up and claims in

respect of such debts may be made against the company. The proviso clarified that where a secured creditor "instead of relinquishing his security and proving for his debt opts to realise the security", he shall be liable to pay expenses incurred by the liquidator for the preservation of the security before its realisation by the secured creditor. The proviso emphasises the position that the secured creditor is still entitled to keep himself outside the winding up proceedings and realise the security without necessity of proving his debts, albeit he shall reimburse the expenses incurred by the creditor, if any, for the preservation of the security before its realisation. It is his option.

14. The proviso to section 529(2) was amended and Explanation was inserted by the very same Act No. 35 of 1985, by which a *pari passu* charge was created in favour of the workmen by inserting the proviso to section 529. Workmen's dues along with the unrealised debt of the secured creditor to the extent they remain unrealised due to enforcement of the *pari passu* charge were placed at par as first priority over all other debts u/s 529A. By amending the proviso and inserting the Explanation, the only change which has been made is that the secured creditor too is liable to pay only the proportionate expenses for preservation taking into consideration the *pari passu* charge in favour of the workmen's dues. But the fact remains, it has yet been left at the option of the secured creditor to realise the security without proving his debt in the winding up proceedings.

15. A close reading of the proviso to section 529(1) also leads to the conclusion that in fact, no charge is created on the estate of the insolvent company, but a charge is created only on the security of the secured creditor which is such creditor's property. Such charge is in fact only against realisation of the security by the secured creditor. It is only if the secured creditor instead of proving his debt in the winding up proceedings as an ordinary creditor, opts to realise the security by keeping himself out of the winding up proceedings that the liquidator becomes entitled to represent the workmen and enforce such charge against the realisation made from the secured property. It is pertinent to note that clauses (a), (b) and (c) of the proviso to section 529(1) come into operation only where a secured creditor instead of relinquishing his security and proving his debt opts to realise the security. It is on exercise of this option by the secured creditor that the liquidator becomes entitled to represent the workmen and enforce the charge under clause (a) of the proviso to section 529(1); that the liquidator becomes responsible for rateable distribution of amounts realised by enforcement of such charge, and it is only if as a result of enforcement of such charge on realisation of security, any part of the debt due to such secured creditor could not be realised by him, to that extent, he ranks *pari passu* with the workmen's dues u/s 529A as per the provisions of sub-clause (c) of the proviso to sub-section (1) of section 529(1).

16. In case, the secured creditor does not opt to realise the security, the liquidator by dint of the proviso to section 529 does not become a chargeholder in the estate of the company so as to exercise the right of a simple mortgagee as

envisaged u/s 100 of the Transfer of Property Act which defines the term "charge". A chargeholder gets a right in the property as under a simple mortgage. It is not the case of the official liquidator, nor can it be read from the proviso to section 529(1) that as a result of the said provision, that the workman becomes a secured creditor of the company having rights of a secured creditor under the law relating to insolvency qua the estate of the insolvent company. The newly inserted provision creating a charge in favour of the workmen and authorising the liquidator to enforce such charge on behalf of the workmen, does not empower the liquidator or the workmen to enforce such charge independent of the option of the secured creditor to realise the security. If the provisions of sub-clauses (a), (b) and (c) of section 529(1) as we see, can be invoked only in case the secured creditor opts to realise the security, it must be held that the exercise of option to realise the security without necessity to prove the debts in winding up proceedings is an option left to the secured creditor to remain outside the winding up proceedings and does not bring him within the winding up proceedings.

17. It is also to be noticed that a charge is created on the security of every secured creditor and not on the property of the company to be wound up. It is apparent from a reading of section 529 that by inserting the proviso to sub-section (1) and sub-section (3), no additional security is created, other than that already existing to encumber the estate of an insolvent company. What has been done is that to the extent the security in favour of the secured creditor is existing, in case the company is being wound up, it is to be shared by the secured creditor with the workmen in the proportion in which the workers dues stand vis a vis the secured debts. This is amply clear from the illustration appended to sub-clause (c) of sub-section (3) of section 529, which makes it clear that if full security of Rs. 1,00,000 is realised and proportion of secured creditor's debt with the workmen's debt is 3 : 1 then Rs. 25,000 will be shared by the workmen and Rs. 75,000 by the secured creditor. To the extent of Rs. 25,000 secured creditors have been deprived of repayment of Rs. 25,000 towards their outstanding due to enforcement of the charge against the security of Rs. 1,00,000. Hence, to that extent, they will rank *pari passu* with workmen's dues u/s 529A as unsecured creditors. If anything beyond that remains due they shall get their priority u/s 530. Workmen too will be able to enforce their charge only to the extent of Rs. 25,000 directly from the realisation, only if the security holder "instead of relinquishing his security" and proving his debt, opts to realise it. Otherwise, they will get their priority only as an unsecured creditor on realisation of assets by the official liquidator. By virtue of the newly inserted provisions the workmen's charge does not exist independent of realisation of security by the secured creditor at his option.

18. If that be the correct position, and in our opinion it is, the conclusion is irresistible that a secured creditor, on option to exercise his right to realise the security without intervention of the court still stands outside the winding up proceedings. Else the very provision of section 529(1)(c) will be rendered otiose

and the words "where a secured creditor instead of relinquishing his security and proving his debt, opts to realise his security...." in the proviso to section 529(1) and (2) will be meaningless. So also the question of the ranking of the unrealised debt of secured creditor to the extent it has remained unrealised on account of enforcement of the charge of workmen's dues, *pari passu* with the workmen's dues at the time of distribution of dividends by the official liquidator shall be a mere surplusage. An interpretation bringing about such a result cannot be accepted.

19. So also, the provisions of section 529A do not militate against the principle enunciated in M.K. Ranganathan's case [1955] 25 Comp Cas 344: AIR 1965 SC 604, by their Lordships of the Supreme Court that the secured creditor, if he decides to realise his security without intervention of the court, is outside the winding up proceedings. Section 529A in respect of secured creditor comes into play only in respect of the debt which has not been realised by the secured creditor and not otherwise. Where a secured creditor opts to realise his security without relinquishing his security and without proving his debt, the realisation is to be governed by the proviso to section 529(1) and the workmen get from such realisation only that much proportion for which they rank *pari passu* qua the realisation of the security. It is only for the remainder, for the purpose of disbursement of dividend by the official liquidator from the realisation made by him from the assets of the company which could not have been realised by the secured creditor, or in respect of which secured creditors have relinquished their security, that workmen's dues are to be paid in all priority. Even then along with the workmen's dues, the debts due to the secured creditor to the extent they could not be realised from the security due to enforcement of the *pari passu* charge of the workmen's dues have also been kept at the same priority as workmen's dues *pari passu*. Section 529A has no application to priorities in respect of realisation of securities by the secured creditors, which have not been relinquished. Such realisation is governed by section 529 alone. Thus, in our opinion, the conclusion is irresistible from the reading of the provisions of sections 529 and 529A read with section 28(6) of the Insolvency Act that the principle enunciated in M.K. Ranganathan and Another Vs. Government of Madras and Others, , unexceptionally still applies to the secured creditor who instead of relinquishing his security and proving his debts opts to realise the security without intervention of the court. In this connection, we may notice the decision of a Division Bench of the Karnataka High Court in International Coach Builders Ltd. v. Karnataka State Financial Corporation rendered in O.S.A. No. 26 of 1991 in Company Application No. 218 of 1991 in Company Petition No. 131 of 1988 decided on January 23 1992 (see [1994] 81 Comp Cas 19).

20. That was a case in which International Coach Builders Ltd. was ordered to be wound up by order dated November 30, 1990, and the official liquidator was appointed who was directed to take charge of all the assets of the company other than those, possession of which was already taken over by the Karnataka State Financial Corporation. The Financial Corporation moved an application u/s 446(2)

(b) of the Companies Act claiming that the its right as a secured creditor of the company be recognised and the right of the Corporation as a secured creditor to stand outside the winding up proceedings and sell secured properties in exercise of its power u/s 29 of the State Financial Corporations Act for realisation of the amount due to the Corporation be also recognised and that the properties be allowed to continue to remain in possession of the Corporation and it be permitted to hand over possession of the properties to the purchaser.

21. The liquidator contested the application, inter alia, on the ground that section 529 as amended and section 529A inserted into the Companies Act by Central Act No. 35 of 1985 conferred on the official liquidator alone, the right to realise the workmen's dues by selling assets of the company wound up, even if a secured creditor of such assets opted to stand outside the winding up proceedings to realise the security and that as the winding up order of the company though made on November 30, 1990, related back to the date of presentation of the petition by the Karnataka State Financial Corporation u/s 29 of the State Financial Corporations Act it cannot exercise the power u/s 29 to sell the same. The company court rejected the contention of the liquidator and granted the application of the Corporation subject to an under taking given by the Karnataka State Financial Corporation respecting the workmen's dues in the company to be wound up. On appeal, the same contentions were raised. Justice N. Venkatachala (as he then was) speaking for the court, while examining sections 529(1) and 529A observed as under (at page 32 of 81 Comp Cas) :

"The proviso to sub-section (2), as it stands after its amendment by Act 35 of 1985, states in unequivocal words that the liability of paying the expenses incurred by the liquidator for preservation of secured creditor's security till its realisation by the secured creditor arises if, such secured creditor, instead of relinquishing his security and proving his debt, proceeds to realise his security. From this position in law itself, it becomes evident that the liquidator's entitlement to represent the workmen and enforce the pari passu charge for workmen's dues under clause (a) of the proviso to clause (c) of sub-section (1) of section 529, cannot arise when he wants to have it standing inside the winding-up proceeding, but only when he wants to have it standing inside the winding-up along with the secured creditor ... none of the said provisions in section 529 or section 529A, as found from their detailed examination, can even remotely suggest that a secured creditor of a company in winding-up cannot stand outside such winding up to enforce his security. On the contrary, some of the said provisions - the proviso to sub-section (1) and the proviso to sub-section (2) of section 529, by which the secured creditor's security is subjected to a pari passu charge for the workmen's dues and expenses of preservation of security by the liquidator till its realisation, in unequivocal language, advert to a secured creditor, who instead of relinquishing his security and proving his debt, opts (proceeds) to realise his security, which cannot happen, as before, except when the secured creditor opts to stand outside the winding-up proceeding and to realise his security. Confining the liability of the secured creditor to his portion

of the expenses incurred by the liquidator in preserving the security by amending the proviso to sub-section (2) indicating how such expenses are to be apportioned to the secured creditor, who has a charge on the security, and by giving deduction on account of the workmen's pari passu charge by adding an Explanation to the proviso to sub-section (2) by amendment, leaves no scope for any one even to think that, after amendment of section 529 and insertion of section 529A, a secured creditor of a company in winding up cannot opt to stand outside the winding up to realise his security. The important change brought about by the amendment of section 529 and insertion of section 529A by Act No. 35 of 1985 is of subjecting the security of a secured creditor to a pari passu charge for the workmen's dues and empowering the liquidator to join the secured creditor in enforcing the workmen's charge on the security when the secured creditor proceeds to realise his security standing outside the winding up."

The aforesaid view of the Division Bench of the Karnataka High Court fully accords with the view which we have taken above, of the provisions of sections 529 and 529A as they stand after the amendment of 1985, with which we are in respectful agreement.

22. In *Karnataka State Financial Corporation v. Patil Dyes and Chemicals Pvt. Ltd.* [1991] 70 Comp Cas 38, the Karnataka High Court was concerned with the question whether the company court has jurisdiction to decide an application moved by the official liquidator representing the workmen for the purpose of enforcement of the charge created under the Act and there is any dispute about such enforcement of right. The court was not concerned with the question whether a secured creditor could proceed to realise his security without the leave of the court where intervention of the court is not required and whether if he does so, the action is invalid. Rather the court accepted this position that the secured creditor of the company in liquidation stands outside the winding up. The court answered the question posed before it in the following manner :

"Even if the secured creditor of the company in liquidation stands outside the winding up, the company court does not lose its jurisdiction u/s 446(2)(b) or (d) of the Act of 1956 over such secured creditor. All that the expression "standing outside the winding up" means is that the secured creditor is given an option to realise the security either by private sale, if he has power to do so, or through court sale, if there is any dispute regarding the nature of the security or the value of the security or u/s 29 of the State Financial Corporations Act, 1951, where the creditor is a State Financial Corporation. But that does not mean that the assets of the company in liquidation, pursuant to an order of the court are taken outside the purview of the jurisdiction of the company court. On a proper construction of section 529 and 529A of the Companies Act, 1956, the workmen's dues and the debts due to the secured creditors to the extent of clause (c) of sub-section (1) of section 529 should be worked out in the light of the illustration given u/s 529, and that could be worked out only by the company court in exercise of its powers u/s 446(2)(b) and (d) of the Act."

23. It may be noticed that there was no provision like section 446(2) in the repealed Companies Act, 1913. Section 446(2) was enacted for the purpose of giving the company court jurisdiction over certain matters provided under sub-sections (a) to (d) of section 446(2) in order to avoid multiplicity of proceedings in multiple courts for realisation and disbursement of assets and to keep proper control of the company court over the affairs of the company respecting these matters. Sub-clause (b) of section 446(2) confers jurisdiction on the company court to entertain and dispose of "any claim" made by or against the company and sub-clause (b) confers the same jurisdiction on the court in respect of the question of priorities or any other question whatsoever whether of law or of fact, which may relate to or arise in the course of winding up of the company. It cannot be doubted that the charge in respect of the workmen's dues in the security held by the creditor is created by the statutory provisions on commencement of the winding up. Therefore, any such claim in respect of the enforcement of the pari passu charge in respect of the security or the pari passu claim of a secured creditor u/s 529(1)(c) and clause (c) to the proviso are questions relating to priority arising in the course of winding up and falls within the jurisdiction of the company court if any dispute in respect thereto arises, to be decided and entertained. Therefore, there cannot be any quarrel with the said principle. However, the case of little assistance on the question raised before us as to whether the secured creditor is under an obligation to seek leave of the court, if instead of relinquishing the security in winding up, he opts to realise the security.

24. The next case relied upon by learned counsel for the official liquidator in this connection in *Kerala Financial Corporation v. Official Liquidator* [1991] 71 Comp Cas 324 of the Kerala High Court. The said decision also does not deal with the question of the right of the secured creditor to stand outside the winding up proceedings and realise the security. The question raised before the court was after the order of winding up is made, whether section 29 of the State Financial Corporations Act at all remains operative and power u/s 29 at all can be exercised by the State Financial Corporation. The court held that as the workmen's dues rank pari passu with the dues of the secured creditor and will have to be paid from the proceeds of the assets of the company, including the security given to the secured creditor section 29 comes into conflict with section 529A of the Companies Act. In resolving this conflict, the learned judge further came to the conclusion that in the best interest of all concerned, the sale could have been conducted by the official liquidator under the supervision of the court.

25. It may be noticed that the case up on an application moved by the Kerala State Financial Corporation itself seeking leave to initiate proceedings against the company in liquidation u/s 29 of the State Financial Corporations Act. It was while considering the said application, the court keeping in mind the interest of the workmen's dues, who now had a charge on the security held by the secured creditor, was of the opinion that in the best interest of all concerned, the sale will have to be conducted by the official liquidator under the supervision of the court.

The question was never raised or decided by the court, whether the Corporation could have stood outside winding up proceedings and realised the security. Therefore, it does not directly concern the issue raised before us. Moreover, with great respect, we are unable to persuade ourselves to agree with the reason that the power u/s 29 comes in conflict with section 529A. It is to be noticed that the charge in favour of the workmen's dues is created u/s 529(1) which itself provides the scope and ambit of the charge and method of its enforcement. It is only in case, a secured creditor opts to realise the security without intervention of the court, that the official liquidator, as representative of the workmen's dues has been authorised to enforce the charge. That charge is obviously against the realisation made by the secured creditor. It is only that portion of the debt which the secured creditor fails to realise as a result of enforcement of the charge, that ranks pari passu with the workmen's dues u/s 529A. Section 529A read with sub-clause (c) of the proviso to section 529(1) envisages that only such portion of the secured debt which has remain unrealised as a result of realisation of the security by the secured creditor due to enforcement of the charge of the workmen only ranks pari passu with the workmen's dues. Therefore, sale by the secured creditor at his option and enforcement of the charge against realisation is a condition precedent before the secured creditor's debt ranks pari passu with the workmen's dues u/s 529A. This necessarily means that it is only all unsecured debts that come within purview of section 529A and the question of applying priority arises on disbursement of dividend by official liquidator. It appears that the attention of the court was not drawn to the language used in the proviso to section 529(1) and sub-clause (c) of the proviso to section 529 which has to be read with section 529A.

26. The next case relied upon by learned counsel for the official liquidator is Maharashtra State Financial Corporation, Bombay Vs. Ballarpur Industries Limited, v. The Official Liquidator, High Court Bombay and Liquidator of M/s. Atrois Chemicals Private Limited, . It is true that the decision of the Bombay High Court supports the contention of learned counsel for the official liquidator. With great respect, we have not been able to persuade ourselves to agree with the same for the reasons already detailed above, for arriving at our conclusion. In our opinion, the judgment stems from an assumption that by dint of the proviso to section 529(1), a charge is created on the estate of a company in favour of the workmen making them a secured creditor, which, in our opinion is not a correct assumption and it also ignores that the stage of enforcement of the charge and pari passu ranking of the secured creditor's debts to the extent it remains unrealised due to enforcement of the charge u/s 529A are both subject to the secured creditor "instead of relinquishing his security and proving his debt opting to realise the same."

We are, therefore, of the opinion that the amendment of section 529 and insertion of section 529A by Amending Act No. 35 of 1985 in the Companies Act has not altered the position of a secured creditor, as envisaged u/s 28(6) of the Insolvency Act read with section 529(1)(c) of the Companies Act to stand outside

the winding up proceedings and realise the security without intervention of the court.

27. The view taken by the learned company judge in the order under appeal, with great respect, is found on the erroneous assumption that a charge is created on the estate of the company in favour of the workmen making them, as a secured creditor and by ignoring the provisions, which expressly made the enforcement of the charge only on exercise of option by the secured creditor to realise his security which obviously is referable to its realisation outside the winding up proceedings and before the priorities u/s 529A come into play and not under the winding up proceedings.

28. It was then contended by learned counsel that the decision rendered in M.K. Ranganathan and Another Vs. Government of Madras and Others, and the view taken by the Karnataka High Court referred to hereinabove, are clearly distinguishable on the facts and not applicable to a case where a secured creditor intends to realise its property and takes possession of the property after the winding up order has been made. It was contended by learned counsel for the liquidator that in M.K. Ranganathan and Another Vs. Government of Madras and Others, , possession of the security was taken by the mortgagee before the winding up order was made and the only question involved in M.K. Ranganathan and Another Vs. Government of Madras and Others, , was the sale of property which was already in the possession of the secured creditor, whereas in the present case, the Corporation has taken action u/s 29, after the winding up order was made and the property came to be in the custody of the court in view of the provisions of section 456(2) of the Companies Act. It was contended by learned counsel for the official liquidator that once the property came into the custody of the court, it was not open to anybody to take that property out from the custody of the court in exercise of the power u/s 29 of the State Financial Corporations Act without leave of the court. This contention need not detain us much. As noticed above, the principle behind keeping a secured creditor outside the insolvency proceedings or winding up proceedings, for the purpose of realising the security or otherwise dealing with security, without intervention of the court is that that right is exercised to enforce the secured creditor's own claim to the property. It also provides that from the date of the order of adjudication and vesting of the insolvent's property in the court, no proceedings or other legal proceedings shall be commenced or the pending suit or other legal proceedings continue. Yet secured creditors are kept out of insolvency proceedings as if sub-section 28(2) has not been enacted.

29. Sections 171 and 232 of the 1913 Act and corresponding section 446(1) and section 456 have the same effected in respect of an insolvent company's property albeit instead of vesting of the property in the court or the receiver, it only comes into the custody of the court. By virtue of section 229 of the 1913 Act, corresponding to section 529(1)(c), the rights of secured creditors of a company under winding up as are under the insolvency law, for the time being in

force, u/s 28(6) of the Provincial Insolvency Act for the present purpose, are kept intact. That is the law. The apex court interpreted the provisions of the Act of 1913 in the light of the position of secured creditors under the insolvency law. Thus, the right of the secured creditor to realise the security is to be exercised as if the provisions of sections 446(2) and 456(2) have not been enacted. If that view is not to be accepted, it will render the provisions of section 529(1)(c) otiose. Therefore, the fact, whether possession of the property was taken by the secured creditor prior to the winding up order or after, has no bearing in so far as the question of vesting of the property in the court of its coming under custody of the court is concerned. Even the right of the secured creditor to deal with the security notwithstanding the fact that the whole property vested in the court is recognised u/s 28(6) of the Insolvency Act and the same principle has been made applicable to the secured creditor of a company ordered to be wound up u/s 529(1)(c). The right of such a creditor, where the property has not vested in the court, but merely is deemed to be taken in the custody of the court, cannot be placed on a higher footing, than in a case where the property is deemed to be vested in the court by statutory provisions. The right of the secured creditor to deal with his security and realise the same without intervention of the court remains unaffected notwithstanding such vesting, or the property coming in the custody of the court, on the principle that the right or intervention of the secured creditor does not come to be in custody of the court (sic). It is to be remembered that where a mortgage is created in favour of the mortgagee he has interest in the mortgaged property and to the extent of the charge or mortgage, the property does not come to the court and is not available for distribution of dividends generally unless the mortgagee relinquishes it or the surplus, if any, comes to the court. Enforcement of such right remains outside the insolvency proceedings or winding up proceedings, as the case may be. Therefore, once we have come to the conclusion that amendment in section 529 and insertion of section 529A does not affect the right of the secured creditor to realise the security without intervention of the court by keeping himself outside winding up proceedings, the further contention that the property being in the custody of the court cannot be taken outside its custody without leave of the court (sic). If that were so; the provisions of section 529(1)(c), which correspond to section 229 of the Act of 1913 read in the light of section 29(6) of the Insolvency Act, as interpreted by their Lordships of the Supreme Court in M.K. Ranganathan's case [1955] 25 Comp Cas 344, would be rendered otiose, because in that event, in no case, after the winding up order has been made, or custody is handed over to the receiver or official liquidator, can the secured creditor remain outside the proceedings of winding up or insolvency inasmuch as in the case of a company, the property would be deemed to be in the custody of the court on making such as order, and in the case of insolvency proceedings, the property shall be deemed to be vested in the court. It is well known that any interpretation which rendered any part of the statute otiose, should be avoided. The distinction pointed out by the learned counsel, therefore, is not of any substance.

30. Lastly, it was contended by learned counsel for the official liquidator that the proceedings u/s 29 come within the purview of other legal proceedings within the meaning of section 446(1). Therefore, it must be held that leave of the company court before taking action u/s 529 in the case of the company ordered to be wound up is necessary u/s 446(1) of the Companies Act. For this proposition, learned counsel placed reliance on the case of *Indian Bank v. V.S. Perumal Raja* [1993] 76 Comp Cas 787 (Mad).

31. Mr. Soparkar, vehemently urged that the Supreme Court in *Maharashtra Tubes*" case [1993] 78 Comp Cas 803 has upheld the contention that the proceedings u/s 29 come within the purview of "legal proceedings" as the expression is defined in Black's Law Dictionary and, therefore, as the proceedings u/s 29 are to be construed as "legal proceedings", leave u/s 446(1) will still be necessary. This argument is stated to be rejected.

32. It must be noticed at the outset that their Lordships in *Maharashtra Tubes*" case [1993] 78 Comp Cas 803 (SC) were considering the provisions of section 22 of the Sick Industrial Companies (Special Provisions) Act, 1985, which places certain restrictions on continuing certain proceedings. Section 22 of the Act of 1985 did not use the term "legal proceedings" but used the wider expression "no proceedings"... shall lie or proceeded with further, except with the consent of the Board or, as the case may be, the Appellate Authority. The Supreme Court first rejected the contention on the ground that the word "proceedings" used in section 22 cannot be given a narrow or restrictive meaning to limit the word to "legal proceedings". Their Lordships further referred to the use of expression "or the like" in connection with the proceedings for winding up or for execution or distress. They also referred to the object of the Act which was "to explore the possibility of reviving the sick unit and restore it to the normal functioning." Obviously, the purpose of the Act of 1985 is to preserve the assets and resources of the company for its revival until the matter is decided finally one way or the other. Therefore, taking all these into consideration, their Lordships observed in the first instance as under (at page 818) :

"... Section 22(1) shorn of the irrelevant part, provides that where an appeal u/s 25 relating to an industrial company is pending, then, notwithstanding anything contained in any other law, no proceedings for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company or for appointment of a receiver in respect thereof shall lie or be proceeded with further, except with the consent of the BIFR or, as the case may be, the appellate authority. The purpose and object of this provision is clearly to await the outcome of the reference made to the BIFR for the revival and rehabilitation of the sick industrial company. The words "or the like" which follow the words "execution" and "distress" are clearly intended to convey that the properties of the sick industrial company shall not be made the subject-matter of coercive action of similar quality and characteristic till the BIFR finally disposes of the reference made u/s 15 of the said enactment. The Legislature

has advisedly used an omnibus expression "the like" as it could not have conceived of all possible coercive measures that may be taken against a sick undertaking... If the Corporation is permitted to resort to the provision of section 29 of the 1951 Act, while proceedings u/s 15 to 19 of the 1985 Act are pending it will render the entire process nugatory. In such a situation the law merely expects the corporation and for that matter any other creditor to obtain the consent of the BIFR or, as the case may be, the appellate authority to proceed against the industrial concern. The law has not left them without a remedy. We are, therefore, of the opinion that the word "proceedings" in section 22(1) cannot be given a narrow or restricted meaning to limit the same to legal proceedings. Such a narrow meaning would run counter to the scheme of the law and frustrate the very object and purpose of section 22(1) of the 1985 Act."

Alternatively, considering the expression "legal proceedings" as defined in Black's Law Dictionary, their Lordships came to the conclusion as under (at page 820) :

"Therefore, even if one goes by the said meaning and understands the term "proceedings" in the light of the object and purpose of section 22(1) of the 1985 Act, no difficulty is experienced in taking the view that it must be widely construed."

Thus, the emphasis was that "the context of the object and purpose of section 22(1) of the Act of 1985" also required a wider construction of the word "proceedings" for the purpose of preserving the property of the company until the outcome of the reference for revival and rehabilitation of the sick industrial company is known. As against this, the object of winding up proceedings is to realise the assets as early as possible of the insolvent company and disburse the dividends in accordance with law amongst various claimants. Therefore, there is no room for enlarging the narrower term used by the legislation of the "legal proceedings" and to read the same simpliciter as "proceedings" overlooking the object and purpose of the Act. As already noticed above and firmly established in *M.K. Ranganathan and Another Vs. Government of Madras and Others*, , it is only where the intervention of the court is sought for realising the security, that is to say, that the security is to be realised through legal proceedings, that leave of the court is required before proceeding further, but if no intervention of the court is sought and if no legal proceedings are to be instituted, the secured creditor is entitled to stand outside the winding up proceedings and opt to realise his security.

33. As a result of the aforesaid discussion, this appeal succeeds. The judgment of the learned company judge is set aside and the application moved by the official liquidator for transfer of possession of the assets of the company hypothecated/ mortgaged with the Corporation as security is rejected. However, it is made clear that from the amount of Rs. 8,99,786.52 which has been realised as sale consideration of the plant and machinery, the proportion of workmen's dues, if not already realised by the official liquidator, shall be realised by him from the

Corporation without any hindrance being put by the Corporation of any sort whatsoever, and the Corporation shall pay the amount demanded by the official liquidator on account of the workmen's share of such realisation within 15 days from the date of making of such demand, failing which the Corporation shall be liable to pay the amount with interest at the rate of 18 per cent. per annum from the date of realisation of the security. However, if any dispute is raised about the workmen's proportion, it will be determined first by the learned company judge on an appropriate application being made in this regard. The future realisation of any security shall also be made only after notice to the official liquidator so that there may not be any delay or obstruction in enforcement of the workmen's charges. The appeal is allowed to the aforesaid extent.

34. We highly appreciate the assistance rendered by learned counsel Mr. S.N. Soparkar, who appeared as amicus curiae, and argued the case on behalf of the official liquidator.