
(1993) 07 DEL CK 0018

In the Delhi High Court

Case No : Company Appeal No. 6 of 1993

Haryana Financial Corporation

APPELLANT

Vs

Pnb Auto Ancillary (India) Ltd. (In Liquidation)

RESPONDENT

Date of Decision : 14-07-1993

Acts Referred:

Citation : (1994) 81 CompCas 588

Hon'ble Judges : J.K. Mehra, J

Bench : Single Bench

Advocate : K.L. Chopra, for the Appellant; B.N. Nayyar and Arvind Shukla, for the Respondent

Judgement

J.K. Mehra, J.—This is an appeal filed by the Haryana Financial Corporation (HFC) against the order of the official liquidator whereby he has accepted the claim of the Haryana Financial Corporation to the extent of Rs. 19,86,847.90 in its capacity as a secured creditor. At the time of hearing, it was pointed out that this claim represents the full principal amount plus interest in terms of the decree in favor of the Haryana Financial Corporation up to the date of the winding up order.

2. The case of the appellant is that being a secured creditor, it is outside the winding up and, as such, is entitled to charge interest at the contractual rate/the rate at which it has been awarded interest under the court decree. This contention has been challenged by the official liquidator.

3. At the time of the hearing, the Haryana Financial Corporation placed reliance upon the terms of its mortgage and the decree passed by the court whereby the District Judge at Faridabad decreed the claim for the two principal amounts being Rs. 2,89,890.01 and Rs. 7,42,560.01 together with further interest at the rate of 12% per annum from May 15, 1975, in respect of Rs. 2,88,890.01 and from June 1, 1975, in respect of the other amount, i.e., Rs. 7,42,560.01. In the absence of any specific provision being made in the decree it will be deemed that the 12% interest awarded would be simple interest. The decree was passed much prior to

the coming into force of the CPC (Amendment) Act, 1976, which came into force with effect from July 1, 1977. At the time of passing of the decree, the proviso to section 34 of the CPC was not there. After the passing of the decree on November 25, 1975, a petition for winding up of the judgment-debtor was presented in 1978 and winding up of the judgment-debtor was ordered on May 6, 1982. The contention raised on behalf of the Haryana Financial Corporation is that the official liquidator could not reject any part of the claim of the secured creditor in respect whereof a court had passed a decree.

4. The official liquidator has pointed out that the position under the Companies Act, 1956, is quite different from that which prevailed under the Indian Companies Act, 1913, and that no interest to any creditor can be paid beyond what has been laid down under rules 156 and 179 of the Companies (Court) Rules, 1959, without any distinction between secured and unsecured creditors.

5. It is further contended that as a consequence of the enactment of section 529A in the Companies Act, 1956, the situation has undergone a significant change whereby the claim for wages of the workmen ranks *pari passu* with the claims of the secured creditors. The official liquidator has to represent the workmen for the purposes of such *pari passu* distribution. Such *pari passu* distribution is not feasible unless and until funds are available to the official liquidator or the security is enforced with full involvement of the official liquidator. For that reason it cannot be said now that the secured creditor can sell the securities without the intervention of the court and that it can appropriate the sale proceeds for the satisfaction of its dues without any reference to the official liquidator or the court as the official liquidator has to represent the workers' interest also. It is for that reason that it is often considered just and equitable and proper that the official liquidator should sell the securities of the secured creditors in consultation with the secured creditors or vice versa. There is also the question as to whether under the provisions of section 34 of the CPC as it existed at the time of passing of the decree, the court could not award *pendente lite* and post-decree period interest in excess of 6 per cent. The question for consideration in such a case would be whether the decree is a nullity being beyond the jurisdiction of the court to award interest at any rate higher than 6 per cent. in view of the specific bar on the powers of the court.

6. On behalf of the H.F.C., reliance has been placed on the case of *Lakshminarayana Sastry (K.V.) v. Vijaya Commercial Bank Ltd.* [1963] 33 Com Cas 47. This authority had dealt with the provisions of the Indian Companies Act, 1913, and it deals with a case where the securities were enforced without the intervention of the court and not a case where the secured creditors had resorted to court auction and a decree was passed. As such this authority cannot be treated as authority on the provisions of law in force in the circumstances of the present case. Another case cited was that of *M.K. Ranganathan and Another Vs. Government of Madras and Others*, which also dealt with the provisions as those existed under the Indian Companies Act, 1913, and the right of the

secured creditor to realise or otherwise deal with his security without the intervention of the court, and was not a case of a decree and the interest payable for the period after the decree. That case dealt only with the sale of the property without the intervention of the court and the Supreme Court had laid down in the light of the provisions of section 229 of the Indian Companies Act, 1913, and section 28 of the Provincial Insolvency Act, that a secured creditor is outside the winding up and he can realise his debt by effecting sale of the mortgaged property by private treaty or by public auction without the intervention of the court. They were not dealing with the question of the rate or the extent of the amount or the rate of interest or the pari passu distribution in favor of the workmen of the company for their wages u/s 529A provided by an amendment to the Companies Act, 1956.

7. The decree in the present case had been passed prior to the amendment of section 34 of the CPC in 1977. It can be contended that even the court which passed the decree had no jurisdiction under the law to award future interest after the date of the decree at a rate higher than 6 per cent. As such, the decree to that extent is a nullity being beyond the competence/jurisdiction of the court and has to be ignored to that extent. On behalf of the Haryana Corporation, reliance has been placed on the case of S.K. Engineering Works and Others Vs. New Bank of India, Batala, . I am afraid that that case has no application to the facts of the present case as that was a case where even the suit had been instituted after the amendment of section 34 by the CPC (Amendment) Act, 1976, which came into force in 1977.

8. The question of award of interest against a company which had gone into liquidation in favor of a secured creditor came up for consideration in the case of West Bengal Financial Corporation and Another Vs. Bertram Scott (I) Ltd. (In Liquidation), , where the Division Bench of the Calcutta High Court had examined the position of secured creditors where the court laid down (at page 382) :

"... It is true that the provisions of the Transfer of Property Act grant the petitioner a right to be paid off its dues in full. But for the enforcement of its rights, the petitioners can sell the mortgaged property. But if it comes to the court for enforcement of its right, it must be regulated by the procedure of the provisions of the Code. Therefore, the provisions of section 34 of the CPC as well as Order 34 of the CPC are applicable for enforcement of the claim in respect of the mortgage and would be attracted in this case."

9. In that very case, the case of AIR 1936 63 (Privy Council) , was referred to in support of the proposition that u/s 34 of the Civil Procedure Code, the contractual relationship between the parties came to an end with the decree and the court had power under this section to allow interest on the decretal amount until realisation. In another case, Shree Bharat Laxmi Wool Store v. Punjab National Bank, [1993] 1 BC 113, the Supreme Court dealt with the position as it prevailed prior to the amendment of section 34 and had modified the High Court order affirming the trial court decree by allowing interest on the decretal sum

only at the rate of 6 per cent. per annum from the date of decree till the date of realisation. In that view of the matter, the only question which remains to be considered on this point of granting future interest under the decree is as to whether awarding interest at the rate of 12 per cent. is a mere illegality in the order or such a decree to the extent it goes beyond what the court is empowered to do u/s 34 is beyond the jurisdiction of the court and, as such, can be ignored. A plea of the decree being a nullity on account of lack of jurisdiction can be set up even in collateral proceedings or execution of decree as has been laid down by the Supreme Court in the case of Kiran Singh and Others Vs. Chaman Paswan and Others, . However, no such plea has been set up in the present case. The relevant provision of section 34 of the CPC reads as under :

"34. (1) where and in so far as a decree is for the payment of money, the court may, in the decree, order interest at such rate as the court deems reasonable to be paid on the principal sum adjudged, from the date of the suit to the date of the decree, in addition to any interest adjudged on such principal sum for any period prior to the institution of the suit, with further interest at such rate not exceeding six per cent. per annum as the court deems reasonable on such principal sum, from the date of the decree to the date of payment, or to such earlier date as the court thinks fit."

10. Thus a plain reading of the section as it existed at the time of the decree shows that there was a clear bar under law on the powers of the court to grant further interest at a rate exceeding 6 per cent. If a decree was based on a compromise where any higher rate was agreed to, that may have to be viewed differently. That is not the case here. Further, it is pointed out that the interest which could be awarded by the court was payable not on the aggregate amount, but only on the principal sum adjudged excluding simple or compound interest. This was laid down in the case of Union Bank of India v. Dalpat Gaurishankar Upadhyay [1992] Mah LJ 686; [1992] 76 Com Cas 494, and the Full Bench of the Bombay High Court in that case has gone on to hold that the above will be the position notwithstanding any agreement or any prevailing banking or trade practice to the contrary. After considering the above position of law, I am of the considered view that the trial court while passing the decree did commit an illegality in exceeding its authority in awarding interest for the period subsequent to the date of the decree at the rate of 12 per cent. per annum. But unfortunately no appeal was filed and the decree was allowed to become final and even the official liquidator has accepted the claim as decreed up to the date of the order for winding up and there is no challenge to the right of the decree holder in this connection. In this view of the matter I do not consider it appropriate to interfere with the decree in these proceedings.

11. The other important question which arises in the present case is as to what will be the position where a set of creditors have stipulations in their contract for charging interest, while another set does not have any such stipulations in the contract but both claims rank *pari passu*. This question has come up for

consideration in the case of Amalgamated Investment and Property Co. Ltd., In re [1985] 3 Com LJ 329. The matter was considered in grant detail and the court after viewing the equities and the relevant rules had laid down that the interest should be allowed to the proved up to the date of winding up. The relevant observations are as under (at pages 336, 348, 349, 355, 356, 361) :

"In short, the three questions which fell to be determined in this application were : (i) whether the interest for which CL is entitled to prove in the winding up of AIP should be calculated down to the commencement of the winding up (March 15, 1976) or down to the date of the winding-up order (May 3, 1976). Interest on the very large debt due from AIP to CL amounted to a significant sum even for that short period; (ii) whether CL is bound to give credit for sums received after proof had been submitted either from the realisation of the assets of SCIPB over which it had a statutory or contractual charge, or by way of dividend in the winding-up of SCIPB; (iii) whether by virtue of the provisions of the Bankruptcy Act the principal sum for which CL is entitled to prove must be disintegrated and recalculated for the purposes of admission to dividend, the part attributable to capitalised interest (including "interest on interest") being limited to statutory interest.

The affairs of a company are in effect put into suspense by the presentation of winding up petition. The making of the winding up order is proof that the company was insolvent at the time of the presentation of the petition, and there is nothing unfair in stopping interest running at the time when the company is to be taken as in a state of insolvency notwithstanding that the ascertainment of its liabilities and the rational distribution of its assets takes place by reference to the later date when the insolvency is established. Thus in the compulsory winding-up of an insolvent company a claim for interest on a debt carrying interest can only be admitted up to the commencement of the winding up, that is the date of the presentation of the petition on which the winding up order is made.

From a proof on a guarantee must be deducted payments made by, or dividends declared on, the estate of the principal debtor before proof is made, but such payments or dividends received after proof is made need not be deducted. If a creditor were to be compelled to deduct payments received or dividends declared before his proof has been admitted, it would be in his interest to press for an early adjudication and to refrain from taking any steps, for instance, to enforce a security against the principal debtor, in the meantime. Grave injustice might, Therefore, result in this and possibly other cases by an alteration in the practice of deducting only sums received and dividends declared before a proof is submitted.

If interest on a debt is allowed to accumulate, or if under the terms governing a debt, it is required to be accumulated, the debt is to that extent, one which includes interest. It cannot make any difference that the compound interest itself bears interest. What matters is not whether it is labelled "principal" and like the original principal bears interest but whether it was in origin interest. Accordingly,

on the facts, part of the proof of debt which included interest, whether capitalised or not, was held to be liable to be recalculated in accordance with the law."

12. In that case, they had gone to the extent of ordering recalculation of the interest and relating back to the date of presentation of the petition. Another case where this question came up for consideration was *Humber Ironworks and Shipbuilding Co., In re : Warrant Finance Co., In re* [1869] LR 4 Ch 643, where, after discussion, Sir G. M. Giffard L.J. observed as under (at page 647) :

"For these reason I am of opinion that dividends ought to be paid on the debts as they stand at the date of the winding-up; for when the estate is insolvent this rule distributes the assets in the fairest way; and where the estate is solvent, it works with equal fairness, because, as soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract; and, on the other hand, a creditor who has not stipulated for interest does not get it.

I may add another reason, that I do not see with what justice interest can be computed in favor of creditors whose debts carry interest, while creditors whose debts do not carry interest are stayed from recovering judgment, and so obtaining a right to interest."

13. In that very case, Sir C. J. Selwyn L.J. has also observed as under (at page 646) :

"I think the tree must lie as it falls; that it must be ascertained what are the debts as they exist at the date of the Winding-up, and that all dividends in the case of an insolvent estate must be declared in respect of the debts so ascertained. Of course, it will be understood that we are laying down this rule as applicable to all cases under the recent Act where creditors' actions are stayed."

14. In the present case before the court, the liquidator has admitted the claim as decreed without any reduction even in the rate of interest awarded by the court up to the date of winding up. I consider that according to the changes in law and rules by amendment of the Companies Act whereby the claim of workmen for their wages has been brought on par with that of the secured creditors ranking such claim of workmen *pari passu* with the claim of the secured creditors, it would be just, fair, equitable and in consonance with the legislative intent that their claim for wages which has no stipulation for carrying interest ranks *pari passu* with the amount due and payable to the secured creditor as on the date of winding up. Any other method would give rise to serious inequities. For instance, if the secured creditor on the date of winding up, was due only a sum of Rs. 10 lakhs inclusive of the interest as accrued till that date and the claim of workmen till that date is also Rs. 10 lakhs and the secured creditor is allowed to compute the amount by including interest which might have accrued subsequent to the date of winding up to the date of realisation of the security and the two were to share the proceeds on *pari passu* basis as the amounts stood on the date of

realisation, the claim of the secured creditor may, with the passage of time, swell to Rs. 20 lakhs or more, while that of the workers for their wages would continue to remain static and, Therefore, they would be entitled to a much smaller share out of the sale proceeds than what they would have been entitled to if the security was realised on the date of winding up order. Such could not have been the intent of the Legislature.

15. On behalf of the Haryana Financial Corporation great emphasis has been laid on the terms of the contract and it has been argued that the interest is really recoverable under the said instrument and in any event, under the terms of the decree up to the date of the realisation. The question relating to the rate of interest under the decree has already been considered and in that view, I think the interest as calculated for the period after the date of decree need not be interfered with. I am unable to accept the argument that the terms of contract will prevail for more than one reason. As already discussed above, once a party comes to court for relief it would be subject to the procedure of the court such as section 34 and Order 34 of the Code of Civil Procedure. The terms of a mortgage which is a contract could be subject to other restrictions including those under rules of equity, justice and good conscience. There is an equitable rule of DAMDUPT which came up for consideration in the cases of mortgages, before the Supreme Court in the case of Mhadagonda Ramgonda Patil and Others Vs. Shripal Balwant Rainade and Others, where the Supreme Court was pleased to observe as under (at page 1204) :

"We may now consider the second question as to whether the rule of Damduput is applicable to a mortgage transaction. Admittedly, it is an equitable rule debarring the creditor to recover at any given time the amount of interest which is in excess of the principal amount due at the time. It is urged by the learned counsel appearing on behalf of the appellants that the rule is applicable only to a simple loan transaction and not to a transaction of mortgage. We are unable to appreciate this contention. In every mortgage there are two aspects, namely, (i) loan, and (ii) transfer of interest in immovable property. As mortgage is principally a loan transaction, we do not find any reason why the rule of Damdupat which is an equitable rule should not apply also to mortgage."

16. Even though it could be contended that the rule of Damduput is not applicable in the present case, as that is the rule under the Hindu law, yet the general principles of equity, justice and good conscience cannot be ignored.

17. Another aspect which appears not to have been considered in any of the rulings is that u/s 28(6) of the Provincial Insolvency Act what is made inapplicable to a secured creditor is whatever has been provided in the rest of the section 28 only and not the whole of the Provincial Insolvency Act or the Rules. Sub-section (6) of section 28 lays down as follows :

"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 has not been passed."

18. Section 529 (1) of the Companies Act provides as follows :

"529. (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".

19. Thus the same rules about the valuation of annuities and future and contingent liabilities as are provided under law of insolvency in determining the future liability of the insolvent would apply in the case of companies under liquidation also. The liability relating to interest also and that has been dealt with u/s 48 (sic). It is clear from the provisions of sub-section (6) of section 28 of the Provincial Insolvency Act that what is left unimpaired is only the power of the secured creditor to realise or otherwise deal with its security and not the effect of insolvency on the chargeability of interest which is governed by the provisions of section 48 of the said Act and also under the Companies Act in the case of a company in liquidation by rules 156 and 179 of the Companies (Court) Rules. I need not go into that position at present, but for the purpose of this case, it is sufficient to hold that the claims of the wages of workmen as on the date of winding up shall rank *pari passu* with the claim of secured creditor, the appellant in the present case, as their claims stood on the date of winding up. Future interest could be paid in terms of the decree in case any surplus is available for distribution after meeting the claims of the workers for their wages and those of other creditors. This would be the only just and equitable way to deal with the present case. That also appears to be in consonance with the legislative intent.

20. Therefore, I accept the appeal to a limited extent and remand the matter back to the official liquidator to examine the claim of the appellant under the decree. The workmen's claim for wages and dues of the secured creditors as on the date of winding up order shall rank *pari passu* with each other and after meeting these claims if there is a surplus remaining, payment to other creditors with regard to their dues be made and if after meeting this liability any surplus is still available, the amount of interest at the rate decreed which had already accrued till the date of realisation of the security, be paid to the secured creditors.

21. In the circumstances of the case, there will be no order as to costs.