
(2004) 08 AHC CK 0169
In the Allahabad High Court
Case No : Special Appeal No. 698 of 2002

I.F.C.I. Limited and Others	Vs	APPELLANT
SIDCO Leathers Ltd. (In Liquidation) and Another		RESPONDENT

Date of Decision : 04-08-2004

Acts Referred:

Civil Procedure Code, 1908 (CPC) — Order 34 Rule 1, Order 34 Rule 5, Order 34 Rule 6
Companies Act, 1956 — Section 125, 529
Provincial Insolvency Act, 1920 — Section 47, 61
Recovery of Debts Due to Banks and Financial Institutions Act, 1993 — Section 18, 31, 34
Transfer of Property Act, 1882 — Section 100, 48

Citation : (2006) 131 CompCas 429 : (2006) 5 CompLJ 492 : (2004) 3 UPLBEC 2512

Hon'ble Judges : Umeshwar Pandey, J; M. Katju, J

Bench : Division Bench

Advocate : V.K.S. Chaudhary, Om Prakash, O.P. Misra and R.S. Maurya, for the Appellant; K.L. Grover and Vikram Nath, for the Respondent

Final Decision : Dismissed

Judgement

This Judgment has been overruled by : ICICI Bank Ltd. Vs. Sidco Leathers Ltd. and Others, AIR 2006 SC 2088 : (2007) 2 BC 51 : (2006) 131 CompCas 451 : (2006) 5 CompLJ 470 : (2006) 2 CTC 847 : (2006) 6 JT 274 : (2006) 5 SCALE 27 : (2006) 10 SCC 452 : (2006) 67 SCL 383 : (2006) 1 SCR 528 Supp : (2006) AIRSCW 2361 : (2006) 6 Supreme 148

M. Katju, J.—We have heard Sri V.K.S. Chaudhary assisted by Sri Om Prakash for the appellants and Sri K.L. Grover assisted by Sri Vikram Nath for the respondents.

2. This company appeal arises out of an order dated 24.5.2002, passed by the learned Single Judge rejecting the objections of the appellants, in this appeal and allowing the application of Punjab National Bank for distribution of the sale proceeds of SIDCO Leather Limited (in liquidation) of prorata basis.

3. The brief facts arises out in this appeal are that the SIDCO Leather Limited (in Liquidation) [in short "the Company (In Liquidation),] was wound up by an order of this Court dated 16.12.1993. The Official Liquidator was appointed as the Liquidator of the Company. By the orders of the Court the assets of the Company were sold by the Official Liquidator and the sale was confirmed on 24.2.1999. The Official Liquidator in pursuance of the order dated 9.4.2001, issued an advertisement inviting claims for settlement under Rule 148 of the Companies (Court) Rules, 1959, from the creditors and ex-workmen. He submitted a Report No. 13 of 2002 to the Company Court stating that he has received claims from Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI), Punjab National Bank and seven ex-workers.

4. The financial institutions, namely, IFCI, IDBI and ICICI are secured creditors. They had sanctioned foreign currency loan and term loans on hypothecation and mortgage of the moveable and immovable assets of the Company. Their charges were registered with the Registrar of the Company at Kanpur u/s 125 of the Companies Act, 1956. The details of the loans advanced by IFCI, IDBI and ICICI as fully secured by creating first charge over the first claim of the Company are the details which are as follows :

A. Foreign Currency Loan:

(i) Name of Institution Amount IFCI DM2,127,565 then equivalent to Rs. 142.36 lakhs (Amount disbursed DM-1, 665,910.202) IDBI Italian Lira 1,380,900,000 then equivalent to Rs. 100 lakhs (Amount disbursed Italian Lira 1,126,078.810) ICICI Italian Lira 1,380,900,000 then equivalent to Rs. 100 lakhs (Amount disbursed Italian Lira 1,161,056,923)

B.(ii) Rupee Term loans aggregating Rs. 277 lakhs under Project Finance Participation Scheme (PFPS) in which shares of the institutions are as follows :

IFCI -Rs. 112.00 lakhs

IDBI -Rs. 110.00 lakhs

ICICI -Rs. 55.00 lakhs

(iii) IFCI - Central Investment subsidy of Rs. 25 lakhs;.

(iv) Rupee Term loan aggregating Rs. 136.05 lakhs under Project Finance Participation Scheme, Share of loans of the institutions are as follows :

IFCI - Rs. 55.02 lakhs

IDBI -Rs. 54.02 lakhs

ICICI -Rs. 27.01 lakhs

(v) Rupee Term loans aggregating Rs. 73.50 lakhs under Project Finance Participation Scheme (PFPS). Share of loans of the institutions are as follows :

IFCI -Rs. 29.72 lakhs (disbursed Rs. 18.20 lakhs);

IDIB - Rs. 29.18 lakhs (disbursed Rs. 17.86 lakhs);

ICICI -Rs. 14,60 (disbursed Rs. 8.94 lakhs).

5. The Company (In Liquidation) failed to repay the loans. The IFCI, IDBI and ICICI (who formed the consortium) filed a Original Suit No. 27811 of 1995. between IFCI and others v. SIDCO Leather Limited, before the Bombay High Court. This mortgage suit was transferred to Debt Recovery Tribunal, Mumbai u/s 31 of the Recovery of Debt issued to Bank and Financial Institution Act, 1993 where it is pending.

6. The IFCI, IDBI and ICICI filed affidavits of proof of debts before the Official Liquidator, U.P. Allahabad u/s 529A of the Companies Act, 1956 read with Rule 149 of the Companies (Court) Rules, 1959. In the affidavit of Sri Balbir Singh, Deputy General Manager (Law), IFCI Limited, Lucknow regional office, after giving details of the financial assistance given to the Company between 1986 and 1991 and other details of the securities in Paragraphs 7, 8 and 9 and the charges created by the Company and filed/registered with the Registrar of the Company, it is stated in Paragraph 11, that IFCI vide its letter dated 4.2.1992 recalled its entire loans alongwith other dues together with further interest as detailed therein. Subsequently IFCI alongwith ICICI and IDBI filed Mortgage Suit No. 2789 of 1995 against the Company (In Liquidation) and others before Bombay High Court which is still pending for disposal. IFCI, therefore, prays that amounts due to it as specified in Schedule I hereto may be paid alongwith further interest at the contractual rates treating IFCI as secured creditors of the Company. Thereafter it was stated in Paragraph 12 that in filing proof of debt, IFCI has not relinquished its securities and therefore, IFCI continued to be the secured creditor on the assets of the Company which had since been sold and charge has been shifted to the sale proceeds and is entitled for payment of its dues on priority basis. It was further stated that filing of proof of debt is without prejudice to the joint Suit No. 2789 of 1995, filed by IFCI and others before the Bombay High Court mentioned above and in the Misc. Application filed before Allahabad High Court.

7. The learned Single Judge by his order dated 24.5.2002, held that where the secured creditor, even if it has first charge over mortgaged assets in preference to other secured creditors, having second charge over the same assets, opts to prove his debts before Official Liquidator and claims dividend by joining the winding up proceedings, it relinquishes his claim over the assets and ranks equal to other secured creditors including those who have second charge over the assets and shall be entitled to pro-rata share out of the sale proceeds subject to the claim of workmen to be determined as provided u/s 529A of the Companies Act, 1956.

8. Sri V.K.S. Chaudhary, learned Senior Counsel submits that the appellants formed a consortium being secured creditors and .having first charge over the

moveable and immovable assets of the Company. The respondent No. 2, Punjab National Bank, has first charge over to the charge of the appellant duly registered with the Registrar of the Company at Kanpur u/s 125 of the Companies Act, 1956 as is clearly mentioned as such in the Memorandum of Entry. The rights of the charge flow from Sections 48 and 100 of the Transfer of Property Act and the interse agreement between the secured creditors, and depend on substantial law and the contract between the parties and cannot be considered abrogated by procedural provisions of other enactments. After the sale of the assets preferential payment has to be made in accordance with the charge created on the assets; Section 529a of the Companies Act, deals with overriding preferential payments. This section should be read with in consonance with Section 125 of the Companies Act and Sections 48 and 100 of the T.P. Act. The payments to the secured Creditors should be made on the basis of the charge created over the mortgaged property. Sri Chaudhary submitted that the Provincial Insolvency Act and Rules, which are procedural cannot prevail over the Companies Act, Transfer of Property Act and Contract Act. He has relied upon Mulla's Law of Insolvency in India Edition, 1997, Page 322, where the learned Author opined that the law applicable to the winding up of the Company is Section 230 of the Companies Act, 1913 and not Section 61 of the Provincial Insolvency Act. Where there is conflict between the two Acts the provisions of Indian Companies Act must prevail. Sri Chaudhary submits that the Insolvency Act and Companies Act, speaks of ranking of. secured creditors as a class over unsecured creditors. They are concerned with the ranking among different types of creditors which matter is governed by Sections 48 and 100 of the Transfer of Property Act and the Contract Act. Section 529(I)(c) of the Companies Act, speaks about the respective right of secured and unsecured creditors as a class. This does not mean that all the secured creditors whether having first and second charge interse under the contract or Sections 48 and 100 of Transfer of Property Act, shall rank together irrespective of the contract or Section 48 of the Transfer of Property Act.

9. Sri Chaudhary, submits that the Punjab National Bank had confirmed vide its letter dated 20.11.1989 that it has second charge subservient to the charges created in favour of the appellant. The Bank also confirmed that the sale proceeds of the mortgaged or hypothecated property shall be first paid to the first charge holder towards all moneys then due from the Company to them and only balances may be paid to the Bank. The total sale proceeds with the Official Liquidator are. Rs. 65,72,311/- The appellants are entitled to get preferential treatment since they hold first charge over the immovable and moveable assets of the Company and only after satisfying the dues of the appellants the remaining amount can be paid to the second charge holders. Sri Chaudhary also pointed out that there is a factual mistake in the judgment of the learned Single Judge when at Page 31 he assumes that since the appellant has joined the winding up proceedings and have submitted proof of their debts they have taken to have given up their securities. This assumption according to Mr. Chaudhary is

incorrect. He has relied upon Paragraphs 10 and 13 of the affidavit of appellant No. 1 where it is stated that the appellants are not relinquishing their securities. Their suit transferred to Debt Recovery Tribunal, is still pending and the decision of the Tribunal is bound to apply to the parties. This Act has overriding effect u/s 18 read with Section 34 of the Act. The suit filed by the appellant is still pending and thus there can be no question of relinquishing the securities of the appellant. The affidavit of proof of debt has been filed in response to the notice issued. The Official Liquidator has sold the mortgaged property and realised the amount which is in deposit with him.

10. The Punjab National Bank has defended the order of the learned Single Judge. According to the Counsel of the Bank once the appellants have applied to the Official Liquidator for proof of their debts and have requested for payment of their dues from the sale proceeds of the assets of the Company (In Liquidation), the appellants have joined in their liquidation proceedings and their claims are to be considered on pro-rata basis alongwith the claims of the Bank and other secured creditors.

11. Section 529 of the Companies Act, 1956 provides for application of Insolvency Rules in winding up of insolvent companies: It applies to the Company which is being wound up on account of its inability to pay debts and introduces Insolvency Rules as regards debts and liabilities. Sub-section (1) of Section 529 provides for in the winding up of an insolvent company and states that 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 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.

12. Sub- (2) of Section 529 provides that all person 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 realization by the secured creditor.

13. The Rules of Insolvency are provided in Provincial Insolvency Act of 1920, and such of these rules as relate to the respective rights of secured and unsecured creditors and to debts provable and to the valuation of the annuities and the future and contingent liabilities are applicable u/s 529 of the Companies Act. The relevant rules are contained in Sections 45to50 of the Provincial Insolvency Act. Apart from these provisions in respect thereof matters, such as those relating to priority of debts all questions have to be determined with reference to the Companies Act. The provisions of the Provincial Insolvency Act have not been incorporated into the Companies Act, 1956 and as such where there is a conflict between the Companies Act, 1956 and Insolvency Act the provisions of the Companies Act, 1956 will prevail. All that is required is that while the established rules which regulate the affairs in insolvency proceedings and the text which would apply for deciding whether a particular assets as vested in the Official Liquidator for distribution among general body of creditors, will equally apply for determining whether a particular asset would vest in the Official Liquidator for distribution.

14. Section 47 of the Provincial Insolvency Act, 1920 is states :

"47. Secured creditors.-(1) where a secured creditor realises his security, he may prove for the balance due to him; after deducting the net amount realized.

(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 realization redeem it on payment to the creditor of the assessed value.

(5) Where a creditor, after having valued his security, subsequently realise it, the net amount realized 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 provision of this section,

he shall be excluded from all shares in any dividend."

15. It is not necessary for a secured creditor to prove his debt in the winding up. He can stand wholly outside the winding up proceedings. He may rely on his security and proceed to realize his debt in the ordinary course of law provided he proceeds with the leave of the Court u/s 446(1) of the Companies Act, 1956, in the case of winding up by the Court. If after exhausting the security anything more remains due to him he may prove for the deficiency in the winding up proceedings or he may value the security without instituting a suit and prove for the balance of the debt after giving credit to the assessed value. But then the liquidator may redeem the security at its value. The secured creditor may surrender the security and give proof of his whole debt vide *State of Punjab and others Vs. Hem Raj*, ; *Bank of Rajasthan Ltd. v. Jai Mata Plywood Co. Ltd.* (1991) 2 Comp. LJ 35 (AH).

16. Where a secured creditor has realized such an amount as may be payable for proceeding against the security, it is open to him to prove for the balance due as ordinary creditor in the winding up proceedings. If he has balance in hand after he has realized the security at the time of winding up, he can set off this balance against his unsecured debts or claims. He can also recover the portion of the security from the Official Liquidator by filing a regular suit without filing a petition under the Companies Act.

17. Section 48 of the Transfer of Property Act provides for priority of rights credited by transfer. It provides that where a person purports to create by transfer at different times, rights over the same immovable property and such rights cannot all exist or be exercised to their full extent together, each later created right shall, in the absence of a special contract or reservation binding the earlier transferee, be subject to the rights previously created. Section 100 of the Transfer of Property Act deals with charges and provides that where immovable property of a person is by act or purpose or by operation of law is made security for the payment of money to another and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property; and all the provisions contained before Section 100 of the Transfer of Property Act which apply to a simple mortgage shall so far as may be, apply to such charge. Whereas mortgage is a transfer of an interest in a property, a charge does not involve the transfer of an interest in the property.

18. In a suit for recovery of an amount due from a mortgaged property the first charge holder has a preference over the subsequent charge holder. Order XXXIV, Rule 1 of the CPC provides that all persons having an interest either in the mortgage security or in the right of redemption shall be joined as parties to any suit relating to the mortgage. The preliminary decree under Rule 2(3) provides that subsequent mortgagees or persons deriving title from, or subrogated to the rights of, any such mortgagees are joined as parties shall be included in preliminary decree for adjudication of their respective rights and liabilities in the manner set forth in Form 9 or Form 10 of Appendix D. Rule 6 provides that

where the net proceeds of any sale held under Rule 5 are found insufficient to pay the amount due to the plaintiff the Court, on an application by him, may if the balance is legally recoverable from the defendant otherwise than out of the property sold, pass a decree for such balance.

19. Section 529A of the Companies Act, 1956 provides for overriding preferential payments. Section 529A states :- .

"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 part 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."

20. The debts of secured creditors are to be paid in full unless the assets are insufficient and in that case the distribution has to be made between the workmen dues and the debts due to the secured creditors, which shall abide in equal proportions for inter se distribution of the sale proceeds among the secured creditors. Section 529A refers back to Section 52(1)(c), which in turn refers to the laws of insolvency.

21. The law of insolvency does not affect the Official Liquidator's rights in the properties vested in him. It however recognises a protocol among the creditors to insist upon the procedure. A secured creditor may remain outside the winding up proceedings and having realized his debt from the securities mortgaged to him he may prove for balance due to him after deducting the net amount realized or to reduce the value of such securities and prove debts for the remaining amount with the Official Liquidator. The rights of secured creditor under the insolvency proceeding is a contingent right and until that contingency happens, he is outside the provisions of Provincial Insolvency Act, 1920. His debt is not provable until he has realized his securities or has abandoned or valued in accordance with Section 47 of Insolvency Act, 1920. In such a case the secured creditor is only entitled to a final decree against the insolvent under Order XXXIV, Rule 6 CPC.

22. In the present case the learned Single Judge found that IFCI, IDBI and ICICI have first charge and that the Punjab National Bank has second charge on the fixed assets of the Company of the working capital of Company of Rs. 134 lakhs by deposit of title deeds created by Company in favour of Punjab National Bank on 21.11.1989. The second charge was subject to the first charge of the appellants. The appellants in spite of filing a mortgage suit in the Bombay High Court, which has been transferred to Debt Recovery Tribunal submitted proof of

their debts before the Official Liquidator and made a request for payment. They did not opt to remain outside the winding up proceeding, nor applied for proof of debt of the remaining amount after valuing the securities for which they have filed mortgage suit and thus it was held that they cannot claim priority over the Punjab National Bank on the fixed assets.

23. We do not find any substance in the submissions of Mr. Chaudhary that the appellants did not relinquish their securities by filing proof of debt before the Official Liquidator or that their claim before the Official Liquidator was based on the balance after deducting the value of the securities. In Paragraph 11 of the affidavit of proof of debt of Sri Balbir Singh, Deputy General Manager (Law), IFCI Limited a prayer was made that the amount due to IFCI as specified in Schedule 1 may be paid alongwith further interest as contractual rights treating IFCI as secured creditor of the company, in subsequent Paragraph 12 it is stated that IFCI has not relinquished its securities and therefore, IFCI continued to be secured creditor on the assets of the company. It was then stated that the proof of debt is without prejudice to the joint Suit No. 2789 of 1995, filed by IFCI and others before Bombay High Court and misc. application before Allahabad High Court, We find-that the reservation made in Paragraph 12 was not intended to keep the appellant outside the winding up proceedings. The appellants made a prayer for payment from out of the moneys realized from sale of assets which was secured with them. We do not find any material on record to show that the appellants had applied to the Bombay High Court for restraining the Official Liquidator to sell mortgaged assets of the Company (In liquidation), which were secured with them or for making any application to the Company Court in that regard. The appellants allowed the assets secured with them to be sold and made a claim for payment from the sale proceeds. They had a right to retain possession to sell the goods with or without the intervention of Court for the purpose of recovering their dues.

24. In Allahabad Bank v. Canara Bank and another AIR 2000 SC 1535, the Supreme Court held that the jurisdiction of the Tribunal and the Debt Recovery Officer under the Recovery of Debts to Bank and Financial Institutions Act, 1993 is exclusive, to adjudicate, execute and distribute the sale proceeds and to workout priority between the Banks and Financial Institution as well as the other creditors. It was held that where the company has not been wound up Section 22 of the Act, give sufficiently wide power to the Tribunal and Appellate Tribunal to decide the questions of priorities subject only to the principles of natural justice and that these powers are wider than those of a Civil Court. Where, however, winding up proceedings are pending the secured creditors are classified into two categories, that is those who desire to go before the Company Court and those who would, like to stand outside the winding up. The first category of all secured creditors are those who go before the Company Court for dividend by relinquishing their security in accordance with the insolvency rules mentioned in Section 529 of the Companies Act. The Supreme Court referred to the Insolvency Rules contained in Sections 45 to 50 of the Provincial Insolvency Act, 1920.

Section 47(2) of the Act, states that a secured creditor who wishes to come before the Official Liquidator has to prove his debt and he can prove his debt only if he relinquishes his security for the benefit of the general body of creditors. In that event he will rank with unsecured creditors and has to take his dividend as provided in Section 529(2). The second class of secured creditors are those who come u/s 529(1)(b) read with Proviso (c). These are those who opt to stand outside the winding up to realise their security. Section 19(19) of the RDB Act, 1993 permits distribution to secured creditors only in accordance with Section 529A of the Companies Act, 1956 which includes the creditors who stand outside the winding up. These secured creditors in certain circumstances can come before the Company Court and claim priority over all other creditors to realise the amounts put of other moneys lying in the Company Court. This limited priority is declared in Section 529-A(1). It is however restricted only to the extent specified in clause (b) of Section 529-A(1). The Canara Bank had lie claims against realisations by other creditors. The Supreme Court found that it has not exercised its option to remain outside the winding up proceedings and thus it was held that the question of such claim can be raised only if the Canara Bank had stood outside the winding up and had realised the amount and if it shows that out of the amounts privately realised by it, some portion has been rateably taken away by the liquidator under sub- clauses (a) and (b) of the Proviso to Section 529(1). It is only then that it can claim that it should be reimbursed at the same level as secured creditor with priority over the realisations of other creditors lying in the Tribunal.

25. For the reasons given above we do not find any error in the order of the learned Single Judge. We may observe here that the cases cited by the appellant, namely. *State Bank of India v. State of U.P.* 2003 (15) ALR 425, regarding recovery of Trade Tax from the mortgaged and hypothecated assets and *Secretary v. U.P. Industrial Bank Ltd.* AIR 1931 Lah 351, with regard to overriding effect of the Companies Act, over the Insolvency Act are not relevant and do not add to the submissions of the Counsel for the appellant.

26. The special appeal is dismissed. No order as to costs.