

(2002) 03 AHC CK 0017

In the Allahabad High Court

Case No : Miscellaneous Company Application No. 1 of 2001

Khalid Mukhtar

APPELLANT

Vs

Buckeye Batteries Private Ltd. (In Liquidation) and Others

RESPONDENT

Date of Decision : 19-03-2002

Acts Referred:

Companies Act, 1956 — Section 446, 446(2), 529, 529A, 530

Citation : (2003) 114 CompCas 70

Hon'ble Judges : Sunil Ambwani, J

Bench : Single Bench

Advocate : Manish Goyal, for the Appellant; Anurag Khanna, for the third respondent, for the Respondent

Final Decision : Dismissed

Judgement

Sunil Ambwani, J.—This application has been filed by Sri Khalid Mukhtar son of the late Mukhtar Hamid Ali, resident of Mukhtar Manzil, Civil Lines, Aligarh, u/s 446 of the Companies Act, 1956 ("the Act"), in the matter of Buckeye Batteries (P.) Ltd. (in liquidation) praying to quash the recovery certificate dated March 29, 2001, issued by Pradeshia Industrial and Investment Corporation of U. P. Ltd. (PICUP) to the Collector, Aligarh ; and to stay proceedings against the applicant as a guarantor of financial assistance granted to the company (in liquidation).

2. By notice dated March 29, 2001, the court did not find any ground to grant interim relief and directed the petitioner to file a supplementary affidavit annexing a copy of the contract of guarantee. The required supplementary along with the bond of guarantee executed in favour of PICUP in Legal Form No. 2 was filed on April 12, 2001. On the same date, the court granted an interim protection to the effect that no coercive action shall take place against the petitioner for realization of the dues claimed by PICUP and for which certificate of recovery has been sent by PICUP to the Collector, Aligarh. On April 16, 2001, this court by a detailed order found that prima facie at that stage the claim set up by the applicant can be examined u/s 446(2)(d) of the Companies Act, 1956, and

required PICUP to file a detailed counter-affidavit. Counter-affidavit was filed by PICUP to which a rejoinder-affidavit has also been filed. The facts giving rise to the above application are stated as below :

PICUP sanctioned a term loan of Rs. 30 lakhs to the company (in liquidation), out of which Rs. 29.75 lakhs was disbursed to the company. Sri Khalid Mukhtar, Dr. Aslam Qadeer and Sri Khursheed Ahmad Khan were promoters of the company for setting up a project for manufacturing of dry cells at Sikandrapur, District Aligarh. On April 30, 1999, the accounts position of the company with PICUP stood as follows :

(Rs. in lakhs)

(i)

Disbursed term loan

29.45

(ii)

Loan repaid

12.67

(iii)

Principal outstanding

16.78

(iv)

Interest overdue

83.18

Total

99.96

A rehabilitation was sanctioned by way of funding of interest and rescheduling of instalments and to agree for pari passu charge, with Canara Bank for their working capital term loan. Since the performance of the company did not improve, PICUP initiated proceedings u/s 29 of the State Financial Corporations Act and took over physical possession on August 23, 1995. In the meantime Company Petition No. 29 of 1993 was filed on November 22, 1993, and a winding up order was passed on April 17, 1995. On November 29, 1995, the court gave order to the official liquidator to take over possession of the assets from PICUP. The official liquidator took over the possession of the assets on December 20, 1995, and prepared inventories.

3. Sri Khalid Mukhtar has executed a bond of guarantee in favour of PICUP to

repay the loan. PICUP invoked the bond of guarantee and issued a recovery certificate to the Collector Aligarh, on March 29, 2001, for realization of Rs. 89,96,651.56 and in addition 16.5 per cent. annual interest with effect from February 1, 2001, as well as 10 per cent. recovery charges, under the U.P. Public Money (Recovery of Dues) Act, 1972. In para. 5 of the recovery certificate, it was stated that in respect of the aforesaid loan Sri Khursheed Ahmad Khan, Dr. Aslam Qadeer and Khalid Mukhtar had executed bonds of personal guarantee on September 16, 1983, to the effect that in case the company failed to pay the loan amount, they shall pay the same as guarantors from their entire movable and immovable properties for which the PICUP had invoked the personal guarantee by notice of demand issued on October 11, 1999.

4. The term loan given by PICUP was secured by equitable mortgage by deposit of title deeds in respect of the company's immovable properties with PICUP and also by bond of guarantee given by Dr. Aslam Qadeer, Khursheed Ahmad Khan and Khalid Mukhtar dated September 16, 1983. The bond of guarantee was executed with the conditions that if at any time fault is made by the company/ borrowers in the payment of the principal sum, interest at 17.5 per cent. per annum or any other moneys for the time being due to the Corporation upon the security of the mortgage, the guarantors on demand shall pay to the Corporation the whole of such principal sum, interest and/or other moneys which shall then be due to the Corporation as aforesaid and will indemnify the Corporation against all loss of principal sum interest or other moneys secured by the mortgage and all costs charges and expenses whatsoever which the Corporation may incur by reason of any default on the part of the company, its successors or assignees. The other clauses of the bond of guarantee shall be discussed while considering the submissions in support of the application.

5. It is admitted that the charge created by mortgage in favour of PICUP was not registered with the Registrar of Companies. Canara Bank made an application for having a first charge over the assets of the company. The application was allowed against which Special Appeal No. 618 of 1997 has been filed. By an interim order in Special Appeal, the official liquidator has been restrained to disburse any money. Sections 446 and 447 of the Companies Act are quoted as below :

"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.

447. Effect of winding up order.--An order for winding up a company shall operate in favour of all the creditors and of all the contributories of the company as if it had been made on the joint petition of a creditor and of a contributory."

6. Sri Manish Goyal appearing for the applicant, has submitted that the applicant Khalid Mukhtar cannot be called upon to discharge the liability, which, in fact, has not been ascertained by the liquidator. The applicant can be liable only to the extent of the liability of the company. The PICUP has lost the charge over the assets of the company by failure of the registration of charge within a period stipulated u/s 125 of the Companies Act, 1956, as a consequence of which the charge has become void against the liquidator. The PICUP has as such, the status of an unsecured creditor and has caused loss to the detriment of the guarantor. He further submits that the debt is barred by time, and that after the date of winding up, the PICUP cannot charge interest from the company and as a consequence from the guarantors. According to Sri Manish Goyal, the question with regard to liability of the company for the purpose of determining the liability of the guarantor, in the facts and circumstances of the case, can be considered as any other question which arises up in the winding up of the company u/s 446(2)(d) of the Act.

7. On the other hand, Sri Anurag Khanna, counsel for the PICUP submits that an application u/s 446 is maintainable only at the instance of the company (in liquidation) and not by a guarantor. The applicant along with other guarantors on the execution of the bond of guarantee have promised to pay the loan in case of default committed by the company and that the entire liability of the guarantor is co-extensive with the liability of company. PICUP is free to recover its dues from the guarantor and in case the amount is not recovered, the guarantor can recover the same from the assets of the company in the hands of the official

liquidator. The failure to register the charge u/s 125 of the Act cannot restrict the right of PICUP to realize the amount from the guarantors.

8. The court has thus been called upon to decide whether the aforesaid application u/s 446 of the Companies Act, at the instance of the guarantor, is maintainable and whether a company court in winding up proceedings can stay the recovery and adjudicate the question of law of guarantor of the company (in liquidation) as against the creditors.

9. Sri Manish Goyal has invoked "quia-timet" principle which entitles a surety to exercise his right before payment. In The Law of Guarantees by Gerald-dine Andrews and Richard Millet, II edition, Chapter 10, this principle has been illustrated. In para. 10-25, the authors illustrate this principle by stating that in most cases no right of indemnity accrues against the principal until after the surety has paid the debt or otherwise discharged the underlying liability, certain rights are available to the surety before this. As soon as the creditor has acquired the right to enforce the surety's obligations under the contract of suretyship, the surety has the right in equity to compel the principal to relieve him from his obligations, even though he has not yet discharged them. The surety can enforce this right by suing in a "quia-timet" action for a declaration that he is entitled to be exonerated and an order that the principal should pay whatever is due to the creditor. Alternatively, he may be entitled to an order that the principal set aside particular fund to pay the creditor, or that he should pay the money into court, though this is perhaps more questionable. The relief to prevent an anticipated injury before it is suffered, is based upon the equitable principle that though the surety is not troubled or molested for the debt, yet at any time after the money becomes payable on the original bond, this court will decree the principal to discharge the debt ; it being unreasonable that a man should always have such a cloud hand over him. The remedy is available both to a guarantor and to a person who has assumed a primary liability to the creditor although as between himself and the principal, he is a surety. This relief against the principal, however, is not available to someone who did not become a surety at the expressed or implied request of the principal. To exercise this right of relief it must be shown that this liability has accrued, in the sense that the creditor could proceed against him forth- with, and that the liability of the surety must be ascertained at that time when he makes an application. The fact, however, is that no demand has been made on either the principal or surety is no bar to "quia-timet" relief. A guarantor is generally discharged if the debtor is discharged by operation of law, for example a short payment of loan to be discharged ; disclaimer of the lease by the debtor's trustee in bankruptcy, or by a company liquidator or by the dissolution of the tenant corporation or where a mortgagee forecloses, and thereafter sells the mortgaged property, a guarantor of the mortgage debt is discharged by operation of law because the mortgage debt is itself discharged in these circumstances. If the guarantee is given in breach of the provisions of the Hire-Purchase Act, where the borrower is discharged, the guarantor is also discharged. However, a surety liable under a contract of

indemnity is not necessarily discharged, if the debtor is discharged by operation of law ; but if the creditor is tainted with any illegality, the surety is protected under a contract of indemnity as well as under the contract of guarantee. If the creditor is guilty of breach of contract as against the debtor, and as a result the debtor is discharged, the guarantor cannot be liable any more than the debtor. Sri Manish Goyal has also relied upon Chitty on Contracts, 27th Edition, paragraph 42-048 and 42-051 in support of his submission that where a creditor had acquired the right to minimum payment of the debt of the guarantor, the guarantor is entitled to call upon the principal debtor to pay the amount of the debt guaranteed so as to relieve the guarantor even though the creditor has not demanded from him or the principal debtor. Para. 245 of the same edition is quoted as below :

"245. Rights of guarantor for company.--Even before the guarantor for a company has paid the guaranteed debt, he may present a petition for the winding up of the company since he is a contingent or prospective creditor of the company. It seems, however, that he cannot prove in a winding up so long as he has not paid the guaranteed debt."

10. It is submitted that the aforesaid principles have been incorporated under Sections 128, 139, 140 and 141 of the Indian Contract Act, 1872. Section 128 provides that the liability of surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract. Section 139 of the Act provides discharge of surety. If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired. Section 140 of the Act provides that where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor ; and Section 141 of the Act provides that a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

11. In the present case, before considering the submissions, it is necessary to examine the terms of the bond of guarantee. The bond of guarantee dated September 16, 1983, is between Dr. Aslam Qadeer, Mr. Khursheed Ahmad Khan and Mr. Khalid Mukhtar termed as guarantors, and PICUP. The guarantee takes into account that the guarantors are the promoters of the company. The second paragraph of the description of the bond of guarantee and paragraphs 1, 6, 7, 11 and 15 are relevant for the purposes of this application, are quoted as below :

"1. If at any time default shall be made by the company/borrower in the payment of the principal sum interest at 17.5 per cent. per annum and/or any

other moneys for the time being due to the Corporation upon the security of the mortgage, the guarantors on demand shall pay to the Corporation the whole of such principal sum, interest and/or other moneys which shall then be due to the Corporation as aforesaid and will indemnify the Corporation against all losses of principal sum, interest or other moneys secured by the mortgage and all costs, charges and expenses whatsoever which the Corporation may incur by reason of any default on the part of the company, its successors or assigns.

6. The guarantee herein contained shall be enforceable against the guarantors notwithstanding that the securities specified in the mortgagor or any of them shall at the time when proceedings are taken against the guarantors hereunder be outstanding or unrealized.

7. The guarantee herein contained shall be enforceable against the guarantors notwithstanding that no action of any kind has been taken by the Corporation against the company/borrower and an intimation in writing sent to the company by the Corporation that a default or breach has occurred shall be treated as final and conclusive proof as to the facts stated therein.

11. The guarantee contained in this deed shall in all respects and for all purposes be binding and operative until repayment in full of all moneys due to the Corporation as aforesaid under the mortgage.

15. The guarantors hereby agree that it shall not be necessary for the Corporation to sue the said company/borrower before suing guarantors for the amount due hereunder."

12. The aforesaid clauses of the bond of guarantee entered into between the guarantors and PICUP for security of the amount, indemnify Corporation against all losses of mortgage and all costs, charges and expenses. In Clauses 6 and 7 guarantors have agreed that the guarantee shall be enforceable notwithstanding the surety specified in the mortgage or any of them shall at the time when proceedings are taken against the guarantors are outstanding or unrealized and that notwithstanding that no action of any kind has been taken by the Corporation against the company/borrower, and an intimation in writing sent to the company by the Corporation that a default or breach has occurred shall be treated as final and conclusive as to the fact stated in the notice. The guarantee is to remain binding and operative until repayment in full of all money to the Corporation under mortgage.

13. Before considering the question whether non-registration of charge u/s 125 of the Companies Act resulted into loss of security, discharging the guarantors to the extent of guarantees liability which is said to be coextensive with the ascertainment of the debt to be determined by the official liquidator under Sections 444, 445 and 528 of the Companies Act and whether the PICUP is entitled to charge interest after the date of winding up ; it is necessary to examine whether this application by way of "quia-timet" relief is maintainable at the instance of guarantor. Section 446(2)(d) quoted as above, provides that in

the question of priorities, or any other question whatsoever whether of law or fact which may relate to or arise in the course of the winding up proceedings, whether such suit or proceeding has been instituted, or is instituted, or such claim or question has arisen or arises, is within the jurisdiction of the court, to be entertained and to be disposed of before or after the order of winding up of the company.

14. In *M/S Patheja Bros. Forgings and Stamping and Another Vs. I.C.I.C.I. Ltd. and Others*, the court while examining the provisions of Sections 22 17(3) 18(2) of the Sick Industrial Companies (Special Provisions) Act, 1985, held that the words u/s 22 of the Act clearly and unambiguously provide that no suit for the enforcement of guarantee in respect of any loan or advance granted to the industrial company concerned will lie or can be proceeded with or without the consent of the board or appellate authority and, thus, the words of the Legislature being clear, the court must give effect to them as they stand and thus the suit for enforcement of guarantees in respect of the loan cannot be provided unless consent as required u/s 22 of the Act is obtained. In *Hazi Raunak Ali Khan v. UCO Bank* [1999] 97 Comp Cas 643 : 3 [1999] CLT 222 (All), the bank filed suit for recovery against the company and against the guarantor. During the pendency of suit, the company was ordered to be wound up. The bank filed an application u/s 446 of the Companies Act praying for grant of leave to pursue the proceedings of the suit filed against the company (in liquidation). The court allowed the application. One of the guarantors of the debt filed an application to recall the order on the ground that the suit filed by the bank had already been dismissed on the date when the application was filed and secondly that it was barred by time. The court found that while hearing the application u/s 446(1) for leave of the court, the guarantor as a defendant in suit was also a necessary party. A restoration application was filed which is also a proceeding in a suit, and that a bar of limitation is not applicable where an applicant is only seeking leave to continue any suit which was instituted prior to order of winding up was passed by the court. The court only recognized the right of a guarantor, and his entitlement to be heard before the order is passed u/s 446(1) of the Act. In the case of *K.S. Shivappa v. State Bank of Mysore* [1986] 60 Comp Cas 229 (Karn), a petition was filed by one of the guarantors of the loan to set aside the sale of the properties of the company in execution proceedings of a decree obtained by the bank and to declare the auction sale as void on the ground that on a winding up petition filed prior to the sale, the company had been ordered by the court to be wound up and that the sale took place when the company was being wound up. He also claimed that the properties could have easily fetched a higher price. The High Court held that u/s 537 any person who is affected by way of attachment or sale of the property of the company (in liquidation) without leave of the court can invoke the provisions and, that the sale was void. In *Deutsche Bank v. S.P. Kola* [1992] 74 Comp Cas 577, the Bombay High Court while examining the provisions of Section 446 of the Companies Act and its object, held that in appropriate cases the company court can, in its discretion, itself

entertain and dispose of a suit in which there are defendants other than the company, under liquidation. In such cases, the company court has full powers to pass a decree against the guarantor to be enforced u/s 634 of the Companies Act. The bank intended to file a civil suit in the Bombay High Court against the company and the guarantor and thereafter filed an application u/s 446 of the Companies Act seeking leave of the company court to file a civil suit against the company and against the guarantor. The High Court on its original side, rejected the contention that since the guarantor was also defendant in the suit, the company court has no power to decide the suit u/s 446(2) of the Companies Act. The company judge granted leave to the applicant to file suit a before the company court in Goa before whom the winding up proceeding of the company (in liquidation) will also continue. The Bombay High Court held that in appropriate cases, the company court can, in its discretion, itself entertain and dispose of a suit in which there are defendants other than the company (in liquidation). In such cases, the company court has full power to pass the decree against the guarantor also which could be enforced against him u/s 634 of the Companies Act.

15. In *Sudarsan Chits (India) Ltd. v. G. Sukumaran Pillai* [1985] 58 Comp Cas 633 in which the Supreme Court considered in para. 7, historical evolution of the provisions u/s 446(2) as well as its present setting and its scope. The said paragraph is quoted as below (pp. 637, 638) :

"Before we advert to the question of construction of Section 446(2)(b), it would be advantageous to notice the historical evolution of the provision as well as its present setting. Section 171 of the Indian Companies Act, 1913, the predecessor of Section 446(1), did not contain any provision similar or identical to that of Section 446(2). Section 171 only provided for stay of suits and proceedings pending at the commencement of winding up proceeding, and embargo against the commencement of any suit or other legal proceedings against the company except by the leave of the court. This provision with little modification is re-enacted in Section 446(1). There was no specific provision conferring jurisdiction on the court winding up the company analogous to the one conferred by Section 446(2). Sub-section (2) was introduced to enlarge the jurisdiction of the court winding up the company so as to facilitate the disposal of winding up proceedings. The provision so enacted probably did not meet with the requirement with the result that the committee appointed for examining comprehensive amendments to the Companies Act in its report recommended that "a suit by or against a company in winding up should, notwithstanding any provision in law for the time being, be instituted in the court in which the winding up proceedings are pending" (see para. 207 of the Company Law Committee Report). To give effect to these recommendations, Sub-section (2) was suitably amended to bring it to its present form by the Companies (Amendment) Act, 1960. The committee noticed that on a winding up order being made and the official liquidator being appointed a liquidator of the company, he has to take into his custody company property as required by Section 456. Section 457 confers

power on him to institute or defend any suit, prosecution, or other legal proceedings, civil or criminal, in the name and on behalf of the company. Power is conferred upon him to sell the properties, both movable and immovable of the company, and to realise the assets of the company and this was to be done for the purpose of distributing the assets of the company amongst the claimants. Now, at a stage when a winding up order is made, the company may as well have subsisting claims and to realise these claims, the liquidator will have to file suits. To avoid this eventuality and to keep all incidental proceedings in winding up before the court which is winding up the company, its jurisdiction was enlarged to entertain a petition, amongst others, for recovering the claims of the company. In the absence of a provision like Section 446(2) under the repealed Indian Companies Act, 1913, the official liquidator in order to realize and recover the claims and subsisting debts owed to the company had the unenviable fate of filing suits. These suits, as is not unknown, dragged on through the trial court and courts of appeal resulting not only in multiplicity of proceedings but in holding up the progress of the winding up proceedings. To save the company, which is ordered to be wound up, from this prolix and expensive litigation and to accelerate the disposal of winding up proceedings, Parliament devised a cheap and summary remedy by conferring jurisdiction on the court winding up the company to entertain petitions in respect of claims for and against the company. This was the object behind enacting Section 446(2) and, therefore, it must receive such construction at the hands of the court as would advance the object and at any rate not thwart it."

16. The object and purpose of Section 446(2) as such is effective winding up of the company and for that purpose to keep all incidental proceedings in winding up before the court which is winding up the company, the jurisdiction was enlarged. In the absence of provision like Section 446(2), the official liquidator was required to realise and recover the claims owed to the company by filing suits, which may have dragged on and ended into expensive litigation. The object was to accelerate the disposal of winding up proceedings by devising summary remedy by conferring jurisdiction on the court winding up the company to entertain petitions in respect of claims for and against the company.

17. In the aforesaid background, examining the prayer of the applicant, I find that basically the object of the application is to determine the right of the guarantor as executor of a surety to the debts of the company. PICUP has undertaken proceedings open to it under law under the State Financial Corporations Act, 1951, and had taken over the assets of the company. The dues of PICUP are a public dues and in case the PICUP is not able to realise the amount due from the assets of the company in the hands of the liquidator in the distribution of the realization of the assets under Sections 529, 529A and 530 of the Companies Act, 1956, it may be open to it to recover it from the guarantor. In such an event, the guarantor can, if law permits, defend itself upon taking the pleas open to it, including pleas with regard to loss of security, charging of interest, etc. The guarantor may also initiate "quia-timet" action in the

appropriate court but it could not be said that the determination of liability of a guarantor is incidental to the proceedings of winding up. Whether the guarantor is liable to indemnify the creditor and the extent of such liability towards PICUP; is not a matter which can be said to be arising out of winding up proceedings, or is necessary to be decided by a company court for effective winding up of a company in liquidation.

18. In the facts and circumstances and without expressing any observation on the merits of the submissions made on behalf of the applicant-guarantor with regard to liability of the applicant as guarantor to PICUP, this application is dismissed on the ground that the relief claimed does not amount to proceedings relating to or arising in the course of winding up of the company (in liquidation). The court also refuses to exercise its discretion to adjudicate the matter which does not concern with the winding up of the company. The application u/s 446 of the Act is, accordingly, dismissed with no order as to costs.