

(2004) 08 DEL CK 0007

In the Delhi High Court

Case No : CA (M) No. 21 of 2002 and CA. 1156 of 2003 in C.P. No.191/97

Morepen Finance Ltd.

APPELLANT

Vs

Reserve Bank of India

RESPONDENT

Date of Decision : 31-08-2004

Acts Referred:

Companies Act, 1956 — Section 125, 450, 531, 531(1)
Negotiable Instruments Act, 1881 (NI) — Section 16, 4, 46, 50, 9
Reserve Bank of India (Amendment) Act, 1997 — Section 45MB
Reserve Bank of India Act, 1934 — Section 45MC(1)

Citation : (2005) 127 CompCas 142 : (2004) 4 CompLJ 357 : (2005) 116 DLT 129 : (2004) 76 DRJ 514 : (2005) 60 SCL 410

Hon'ble Judges : A.K. Sikri, J

Bench : Single Bench

Advocate : Parag Tripathy, Manmohan Sharma, Monica, Priya and Mahesh Prasad, Sudhanshu Batra, M.D. Kanther and Bhuvan Gugnani, S.K. Luthra and Manisha Tyagi, Counse, for the Appellant;

Judgement

A.K. Sikri, J.—Reserve Bank of India (RBI), as the petitioner, filed C.P.191/97 u/s 45MC1(c) of the Reserve Bank of India Act for winding up of CRB Capital Markets Ltd (hereinafter called 'the company'). Along with this petition, RBI also moved CA.552/97 for appointment of the Provisional Liquidator u/s 450 of the Companies Act,1956. This petition came up for hearing on 22.5.1997 when the Court appointed the Official Liquidator attached to this Court as the Provisional Liquidator with direction to him to take into control and custody all the assets, properties and books of accounts of the company. Since then the Official Liquidator is controlling the affairs of the company. However, it may also be mentioned at this stage that the ex-Director of the company has submitted the application for revival of the company in which orders were passed on 22.3.2002 directing to convene meetings of secured creditors, unsecured creditors and share holders. The proceedings in the company petition are going on. The Scheme for Revival has not yet been approved. However, many creditors have come forward who have lodged their claims.

2. The applicant in the present application, namely, M/s. Morepen Finance Ltd. is one of the creditors. The applicant is not lodging its claim with the Official Liquidator as a creditor. Its case rests on different footing altogether. According to the applicant it had given an Inter Corporate Deposit (ICD)/loan to the tune of Rs.70 lacs to the company on 15.1.1997. It was repayable after 90 days with 24.5% interest p.a. While taking this ICD from the applicant, the company had endorsed and delivered to the applicant an ICICI Bond (hereinafter referred to as 'the bond') of the face value of Rs.1 crore by making following endorsement "pay to Morepen Finance Ltd. or order". The company had also delivered two post dated cheques both dated 16.4.1997; One for Rs.70 lacs (representing principal) and another for Rs.3,31,959/- (representing interest) in favor of the applicant along with the said bond. Mr. C.R. Bhansali, Director of the company also gave letter dated 15.1.1997 to the applicant confirming that the said bond stood in applicant's name and also stated in the said letter that in the event of dishonour of aforesaid two cheques, the applicant would be entitled to get the said bond transferred in his favor or sell the same and appropriate the proceeds thereof to itself. The exact language appearing in the said letter, to this effect, is as under:

"get the said bond transferred in your favor or sell of the same and adjust the proceeds thereof towards principal and interest payable to you and the balance if any be remitted to us".

3. On 15.4.1997, before the due dates of cheques, the RBI issued a Notification dated 10.4.1997 u/s 45MB of the RBI (Amendment) Act,1997 thereby directing the company not to sell, transfer, create charge or mortgage or deal in any manner with any of its properties and assets without the permission of the Bank for a period of six months from the date of said notification. In view of this notification, as the bank accounts of the company stood frozen, the inevitable consequence thereof was that the two post dated cheques issued by the company in favor of the applicant were returned dishonoured by the bank. This happened on 19.4.1997.

4. The submission of the applicant is that because of the endorsement on the bond in its favor the applicant became the owner of the said bond and acquired right to get it transferred in its name. Further, according to the applicant, in view of the dishonour of the two cheques, the applicant also became entitled to sell the said bond and adjust the proceeds thereof towards payment of principal and interest payable to the applicant which was also specifically authorised by the company vide its letter dated 15.1.1997. However, ICICI Bank because of the instructions of the RBI refused to honour the bond and the obligation there under. This compelled the applicant to file the writ petition No.3600/97 in this court. In this writ petition while issuing show cause notice dated 3.2.99 the court also directed the bank to deposit the interest accrued on the bond in the name of Registrar of this Court. The Official Liquidator as well as ICICI filed counter-affidavits in the said writ petition taking objection to the maintainability of the said writ, inter alia, on the ground that in view of provisional winding up of the

company the appropriate remedy of the applicant was to move the Company Court for appropriate reliefs. In these circumstances, present petition is filed by the applicant with the following prayers:

- a) Order that the notification issued by the RBI and the orders in the winding up matter are not applicable to the applicant and,
- b) Pass appropriate directions for registration of ICICI bond bearing No.B910287/10000 endorsed and delivered in favor of the applicant.
- c) Direct the Registrar of the Delhi High Court to release a sum of Rs.78 lacs deposited with him as accrued interest on the said bond in favor of the applicant.

5. It would be necessary to record at this stage that since reliefs prayed for in this application as well as in the writ petition were same, learned counsel for the petitioner at the time of arguments informed the court that the writ petition had since been withdrawn.

6. The case of the petitioner, in nutshell, is that the applicant is the holder in due course of the said bond and as it has become the owner thereof, it has right to get the same registered in its favor and has also right to get interest which has accrued thereon.

7. This prayer is contested by the Official Liquidator, Reserve Bank of India as well as the ex-Director of the company. Their stand is that the applicant has not become the owner of the bond. For the loan advanced by the applicant it may be the creditor, that too unsecured creditor. Since there is an order of provisional winding up, the only remedy for the applicant is to lodge its claim before the Official Liquidator as and when such claims are invited. Alternatively, if the Scheme of Reconstruction is accepted, to get the payment in accordance with the terms of the Scheme that may be sanctioned. The Official Liquidator has additionally stated that prima facie the transaction in question would be hit by the provisions of Section 531 of Companies Act and as it is "fraudulent preference". Whether it is in fact a fraudulent preference or not we will have to be examined at the appropriate stage which had not ripened so far. The instant application, Therefore, at the most, be treated as an application of a creditor lodging its claim before the old and as the security in the form of bond was not registered with the Registrar of Companies, the applicant cannot even be treated as a secured creditor in the eyes of the Official Liquidator because of the legal position contained in Section 125 of the Companies Act. Mr. Batra appearing for the ex-Director additionally submitted that the two post dated cheques were given, the maturity date which was after 15.4.1997 when ban had been imposed vide notification by the RBI u/s 45MB of the RBI (Amendment) Act,1997 and, Therefore, when these cheques were dishonoured after that date, the position of the applicant would be that of unsecured creditor only.

8. Before appreciating the rival contentions, it would be useful to recapitulate some of the relevant dates.

15.1.1997- When the ICD of Rs.70 lakhs was given by the applicant to the company. The bond and the two post dated cheques were handed over by the company to the applicant along with a letter of even date.

16.4.1997- The two post dated cheques are of 16.4.1997.

15.4.1997- Notification dated 10.4.1997 u/s 45MB of the RBI (Amendment) Act,1997 issued by the RBI.

16.4.1997- Two cheques on due date were presented in the bank.

19.4.1997- These cheques were returned dishonoured .

22.5.1997- In CP.191/97 show cause notice issued and provisional liquidator appointed.

9. The relevant portion of Section 531(1) of the Companies Act may be reproduced at this stage.

"531. Fraudulent preference.-(1) Any transfer of property, movable or immovable, delivery of goods, payment, execution or other act relating to property made, taken or done by or against a company within six months before the commencement of its winding up which, had it been made, taken or done by or against an individual within three months before the presentation of an insolvency petition on which he is adjudged insolvent, would be deemed in his insolvency a fraudulent preference, shall in the event of the company being wound up, be deemed a fraudulent preference of its creditors and be invalid accordingly:

Provided that, in relation to things made, taken or done before the commencement of this Act, this sub-section shall have effect with the substitution, for the reference to six months, of a reference to three months".

10. It is on the strength of this provision the non-applicants are contending that since the bond was endorsed in favor of the applicant within six months before the commencement of the winding up proceedings against the respondent company, prima facie it would be a case of "fraudulent preference" in view of order dated 22.5.1997 provisionally winding up of the company. Further since two post dated cheques were dishonoured, the applicant acquired right to claim the said amount from the company and thus it became a creditor. However, before this debt of the applicant could be discharged by the company, the provisional liquidator was appointed and, Therefore, the applicant would stand at par with other unsecured creditors and the present application is an attempt by the applicant to redeem its debt by this ingenuous methodology whereby attempting to be on a better footing than even a secured creditor.

11. On the other hand, according to learned senior counsel for the applicant, the question of becoming secured and unsecured creditor in the manner projected by the non-applicants does not arise. His submission is that the applicant had become the owner of the bond in question. This bond was an encashable

instrument in the nature of promissory note which could be transferred/endorsed in favor of the applicant and this was done as far as back as on 15.1.1997 i.e. much before the petition for winding up was filed. The said bond was for valuable and valid consideration as the applicant had given ICD to the tune of Rs.70 lakhs. Bond was delivered to the applicant on the same date, namely, 15.1.1997. He further submitted that this case, on facts, was not covered by the provisions of Section 531 of the Companies Act as the transaction was not "fraudulent" in nature. It was a contemporaneous act on the part of the parties, namely, the applicant and the company whereby the applicant gave ICD / loan and on the same date, to secure that loan the company handed over the bond to the applicant with proper endorsement. There was thus no element of fraud. Moreover, because of the endorsement, the applicant had become the owner of the bond/ holder in due course. Referring to various provisions of the Negotiable Instrument of the Act, it was argued that since the applicant had become the owner on 15.1.1997 itself, it had right to get the same transferred in its name or sell the same.

12. From the arguments of the parties, as noted above, it is clear that following questions arise for consideration:

A. What are the rights of the applicant qua the bond in question? To put it differently, whether the applicant is the holder in due course of the said bond and, if so, when he became the holder in due course/owner of the bond?

B. If the poser 'A' above is decided in favor of the applicant, then whether the transaction in question would amount to fraudulent preference and be hit by the provisions of Section 531 of the Act?

A: RIGHTS OF THE APPLICANT IN THE BOND:

The bond in question is an ICICI Bond No. B910287/10000 for Rs.1 crore. It is written on this bond that it is "INSTRUMENT BY WAY OF BOND IN THE NATURE OF PROMISSORY NOTE". It is 20 year bond which carries 12% interest p.a. Payable half yearly i.e. on 23rd June and 23rd December each year. The original owner of the bond, in whose name the bond was originally issued by ICICI, was Standard Chartered Bank. It is in the nature of promissory note. The relevant words are "in consideration of value received do hereby promise to pay to Standard Chartered Bank or order the sum of Rs.1 crore only".

13. Two things are clear. It is a promissory note and it is negotiable. In fact this instrument was negotiated from time to time as is clear from the endorsements made on that instrument. Along with the Bond is the printed instrument of endorsement which has the following heading:

"ENDORSEMENT AS TO PAYMENT OF INTEREST AND TRANSFER"

14. Thus the endorsement on the instrument signifies the same to be relating to the 'payment of interest' as well as the 'transfer'. Standard Chartered Bank made transfer /endorsement in favor of 'Deutsche Bank' and thereafter

successive endorsements in favor of other parties are made before it came into the possession of the company by same methodology i.e by means of endorsement in its favor. All these endorsements are in favor of transferee "or order" . Similar endorsement is made by the company in favor of the applicant. It reads " pay to Morepen Finance Ltd. or order".

15. We may have to scan through some of the provisions of Negotiable Instrument Act to understand the effect of the aforesaid endorsement of the Promissory Note. Apart from de facto description of the bond as a Promissory Note, that is the de-jure position also, when we go through the definition of Promissory Note as contained in Section 4 of the Act. This section reads as under:

Section- 4. "Promissory note".- A "Promissory note" is an instrument in writing (not being a bank-note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument."

16. Undoubtedly the writer of the bond, namely, ICICI Bank has given an unconditional undertaking to pay Rs.1 crore to a particular person or to the order of the said person named in the bond. This exercise of ascertaining the character of the endorsement became necessary as learned counsel for the Official Liquidator had challenged though a faint one at that real character of the instrument in question. With this, we come to second limb of this issue we are discussing.

17. Endorsement in favor of applicant is made in no uncertain terms, the delivery thereof was also given to the applicant and the bond in question is in the possession of the applicant. The applicant would thus become " holder in due course" as the requirements thereof as contained in the definition of this expression in Section 9 of the Negotiable Instrument Act are duly met with. For easy reference, this Section is also reproduced here:

9. "Holder in due course".- "Holder in due course" means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or endorse thereof, if [payable to order], before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title".

18. Neither there is a dispute that the applicant came to possess the said bond for valid consideration nor there is a dispute about the endorsement. It is also not challenged by the non-applicants that there is any defect which exists in the title of the company which endorsed this bond in favor of the applicant. In Braja Kishore Dikshit Vs. Purna Chandra Panda AIR 1957 Orissa 153 the Court held that three conditions are necessary to be holder in due course. Firstly, he must be a holder for consideration, secondly the instrument must have been transferred to him before it becomes overdue, and thirdly he must be a transferee in good faith, and that he should not have any reason to believe that

there was any defect in the title of the transferor. All these conditions are satisfied, beyond doubt. It may be pointed out at this stage that vide order dated 16.5.2002 this court had appointed Mr.Rajiv Shakdhar, Advocate as the Court Commissioner with direction to make a report as to whether transaction between the parties was bona fide and not anti dated. After necessary inquisition, he submitted his report dated 1.8.2002. The penultimate para of this report i.e. para-12 records his observations and in the last para i.e in para no.13 he has concluded that endorsement is valid and genuine. We may reproduce paras 12 and 13 for our benefit:

12. "I have perused the documents produced before me i.e. the Bond, letter dated 15th Jan.,1997 and letter dated 9th May, 2002, issued by I.C.I.C.I. Bank Ltd., certifying the fact that the bank drafts issued had been drawn in favor of C.R.B. And Wockhard Ltd. for the value stated in the application. It is also noted that none of the parties i.e. the Reserve Bank of India, the Official Liquidator or the C.R.B. has placed any evidence, documentary or otherwise, to impugn the veracity of the transaction i.e. the deposit of Rs.70.00 lacs as Inter-Corporate deposit by Morepen with C.R.B.

13. In these circumstances, it is clear that there is nothing to suggest that CRB did not endorse the Bond as security in favor of Morepen, on 15th of Jan.,1997, in lieu of the ICD made over by Morepen in favor of CRB. I have nothing further to add in respect of the transaction in issue".

20. It may, however, be mentioned that endorsement on the Promissory Note can be " in blank" or " in full" as provided in Section 16 and both these kinds of endorsements would be valid. In the instant case, the endorsement made by company specifically records the name of the applicant with suffix " or order". By delivery of this bond, with the aforesaid endorsement on this instrument, which instrument is in the nature of Promissory Note, the making of endorsement becomes complete as provided in Section 46 of the Negotiable Instrument Act. Once this gloss about the nature of the Bond and the nature of the transaction is clear, the right of the holder in due course of such a negotiable instrument on which there is an endorsement coupled by delivery, is to be found again, in the Negotiable Instrument Act itself. This statutory answer is contained in Section 50 of the Act as would be clear from its reading:

50. Effect of indorsement.- " The indorsement of a negotiable instrument followed by delivery transfers to the indorsee the property therein with the right of further negotiation; but the indorsement may by express words, restrict or exclude such right, or may merely constitute the indorsee an agent to indorse the instrument, or to receive its contents for the indorser, or for some other specified person".

21. Thus legal title passes to the transferee so as to enable him to demand, receive or sue for money to be paid under that instrument. The aforesaid discussion sums up the legal position in favor of the applicant.

22. No doubt the company had given two post dated cheques for repayment of the ICD together with interest and in the normal course, on the dishonour of these cheques, the applicant would have only become entitled to recover this amount from the company and once there is an order of winding up, such person would only be a creditor who can make demand from the Official Liquidator by lodging the claim. However, that would be the position in the absence of the delivery of bond and passing title in favor of the applicant in the said bond. It is clear from the transaction in question that while advancing the loan by means of ICD the applicant secured the same by getting the Bond endorsed in his favor. Had the two cheques been honoured, the company could force the applicant to endorse the bond back in its favor. The applicant, however, was not willing to take any chance and was not satisfied with these two post dated cheques. It wanted to play safe and it is for this reason that it was agreed that, for whatever reason, if the payment from the two post dated cheques is not realized, the applicant would be entitled to sell the bond. This becomes abundantly clear when we read letter dated 15.1.1997 written by the company to the applicant giving authority for this purpose. Thus the legal right which accrued in favor of the applicant with the endorsement and delivery of the bond was confirmed by the company by stating the obvious in its letter dated 15.1.1997. The transaction has to be examined as one package and the dishonouring of the two cheques cannot be looked into in isolation without keeping in mind the effect of transferring the title in the Bond in favor of the applicant. It can be said at the most, that the applicant deferred his rights in the said bond, which accrued in its favor on 15.1.1997 with the endorsement and making him holder in due course, till the encashment of cheques. However, once the cheques were dishonoured, the applicant became entitled to sell the bond in terms of letter as per authorization made by company vide its letter dated 15.1.1997 and it had agreed to defer his right to deal with that bond till the encashment of the cheques. That would be the plain and simple legal effect. Right in the bond would not accrue for the first time on the dishonour of the cheques. Such right was already there which accrued on 15.1.1997 in favor of the applicant.

23. B: Whether transaction would amount to "fraudulent preference":

We have already taken note of the provision of Section 531 of the Act. The transaction in question is dated 15.1.1997 and provisional winding up order was passed on 22.5.1997. This transaction is clearly within six months from the commencement of its winding up. However, in order to attract deeming provision contained in Section 531(1) of the Act, another aspect to be seen is as to whether such a transaction would be a "fraudulent preference" if such application had arisen in an insolvency petition against an individual. One has to, Therefore, examine the definition of fraudulent preference as contained under the Bankruptcy Law or Insolvency Law. This position has been judicially determined in number of cases and I would refer to these cases soon hereafter. I may, however, note at this stage itself that the principal laid down in these cases is that it is not enough to show that preference was shown to a particular

creditor. It also must be shown that it was done with a view to give him favored treatment. A probe into the debtors mind is thus involved. This ingredient is to be established to make out a case of fraudulent preference u/s 531 of the Act.

24. In the case of *Rajaram and Another Vs. Ganpati and Others*, , which was a case under Provincial Insolvency Act, this principal was explained by observing that:

" Where one of the creditors of the insolvent takes a transfer of the insolvent's property for partly satisfying his genuine debt with full knowledge of the insolvent's indebtedness to other creditors, it is a case of preferring one creditor to the others but that in itself is no ground for annulling the transfer. The good faith or bad faith of the debtor-insolvent is immaterial. What has to be seen is whether the transferee acted in good faith in taking the transfer. If the dominant intention of the transferor is to benefit the debtor as against the creditors, the transferee cannot be said to act in good faith. But if in satisfaction of the amount due to him, the creditor takes a transfer from the debtor, without undervaluing the property, it cannot be said that he is acting in bad faith even though the effect might be to defeat the other creditors. A creditor is entitled to safeguard his own interest".

25. By referring to certain earlier pronouncements, the court concluded:

A: There is a consensus of opinion that in the case of the annulment of a transfer the burden of proof is on the official receiver of the creditors to prove the absence of good faith as well as of valuable consideration.

B. If valuable consideration is proved, good faith follows and the creditor or the receiver has to prove by way of cogent evidence that there was want of good faith in the transaction.

C. There may not be any direct evidence of want of good faith but the circumstances must be such as to lead to the only conclusion that the transfer in favor of the transferee lacked in good faith.

D. It must be shown, in addition that " the real object of transfer is to place the property beyond the reach of the creditor for the benefit of the debtor and is not for the payment of his debts" but for protection of his interest. Thus dominant intention must be to benefit the debtor as against the creditor.

26. In the case of *Official Liquidator, Victor Chit Fund P. Ltd. Vs. Kanhiya Lal and Others*, this court held that in an application to set-aside transaction fraud must be clearly alleged, proved and established. No doubt that such a stage has not reached, nevertheless it can be safely concluded from the facts of this case that there is not even a semblance of fraud alleged.

27. In *Official Liquidator, Kerala High Court Vs. Victory Hire Purchasing Co. (P.) Ltd. and Another*, , Kerala High Court laid down the test of finding out fraudulent preference in the following words:

"The essence of fraudulent preference is the giving of an improper benefit to a few creditors leading to inequality between them and the generality of creditors. In order to establish that fraudulent preference was shown to a particular creditor it must also be shown that it was done with a view to giving him favored treatment. The dominant motive attending the transaction has to be ascertained and if it is tainted with an element of dishonesty, questions of fraud arise. A probe into the debtor's mind and an assessment of the various motives that animate human conduct is thus involved. Since the inference relates to dishonesty or something approaching dishonesty, there must be solid grounds for drawing it. If the circumstances proved are equally consistent with guilt or innocence, the benefit of doubt goes to the accused. Suspicion, however, strong, will not be sufficient; if there is room for more Explanations than one for the debtor's conduct, an intent to prefer cannot be inferred in the absence of direct evidence. There is no fraudulent preference if the payment or transfer is not voluntary. The payment of debts by a company under threat of legal proceedings or under reasonable apprehension of such proceedings does not amount to showing of preference. However, a payment made or benefit given to a creditor is not considered to be involuntary merely because the company had previously promised to make or give it at a time when it was solvent".

28. These very principals are reiterated in the case of Monark Enterprises Vs. Kishan Tulpule and others, and in the case of Mukand Iron and Steel Works Ltd. Vs. Karnataka Steel and Wire Products Ltd. and Others, .

29. Keeping in view the aforesaid principals in mind, it cannot be said that transaction in question would amount to `fraudulent preference". Transaction is of a date before even winding up petition was filed. Further valuable consideration is proved as the applicant advanced loan in the form of ICD in consideration whereof the Bond in question was endorsed. Therefore, good faith in the transaction follows and there is not even a suggestion either by the Official Liquidator or the ex-Director or RBI which could shake this presumption, what to talk of any cogent evidence establishing want of good faith. It was a contemporaneous act. It was not a case where ICD was given much earlier and the applicant was subsequently, to secure that loan, given the Bond. The report of the Court Commissioner, to which reference has already been made, has found the transaction to be genuine. Therefore, it cannot be termed as a `fraudulent preference".

30. As a sequitteur, as both the questions are answered in favor of the applicants, the prayers made in the application warrant to be allowed. Since the applicant had become the `holder in due course" of the Bond in question on 15.1.1997 and has right to deal with the Bond as its owner, the ICICI would be duty bond to register the same in favor of the applicant and to pay the applicant interest/dividend thereon. The Notification dated 10.4.1997 issued by the RBI or the winding up order dated 22.5.1997 would not come in the way of applicant in getting this relief. ICICI is, Therefore, directed to register the bond bearing No.

B910287/10000 in favor of the applicant and pay the applicant interest thereof. Interest which the ICICI has deposited in this court, pursuant to orders passed in CWP. No. 3600/97, shall also be released in favor of the applicant by the Registrar of the Court.

31. These applications are disposed of with these directions.