
(1990) 10 KL CK 0023
In the High Court Of Kerala
Case No : M.F.A. No. 173 of 1990

M.V. Paulose

APPELLANT

Vs

City Hospital (P.) Ltd.

RESPONDENT

Date of Decision : 04-10-1990

Acts Referred:

Companies Act, 1956 — Section 433, 434

Citation : (1992) 73 CompCas 362 : (1991) 2 ILR (Ker) 946

Hon'ble Judges : Varghese Kalliath, J;T.V. Ramakrishnan, J

Bench : Division Bench

Advocate : K. Ravindranathan Nair, for the Appellant; C.M. Devan, for the Respondent

Final Decision : Dismissed

Judgement

Varghese Kalliath, J.—This appeal arises from winding up proceedings, C. P. No. 47 of 1989. A learned single judge of this court conditionally dismissed the petition. The petitioner is aggrieved. He files the appeals. The facts are these :

2. The appellant submitted that the respondent-company owed a sum of Rs. 1,74,709.12 to the appellant. The appellant sent a letter marked in the proceedings as annexure B to the company requesting to pass a resolution authorising the cashier or accountant to allow the petitioner to draw Rs, 1,000 daily from the cash counter towards the above said dues. It is stated that the board of directors passed a resolution resolving to pay Rs. 5,000 to the petitioner every month, by resolution dated May 8, 1989. But, the company defaulted in payment. Therefore, a notice was sent to the respondent-company, exhibited as annexure C in the proceedings calling upon the respondent-company to pay the said amount to the appellant. The board of directors of the respondent-company passed another resolution on June 24, 1989, whereby it was resolved that the company should pay to the appellant the amount claimed in monthly instalments of Rs. 10,000. Even though such a resolution was passed, the company did not pay any amount to the appellant. Further, it is stated that the company owes an

amount of Rs. 2.25 lakhs to the Kerala State Electricity Board and Rs. 50,000 to the Provident Fund Commissioner, Rs. 3 lakhs to debenture loan holders and over Rs. 3 lakhs to banks. It is also stated that the company has to pay to the directors and other individuals Rs. 5 lakhs.

3. The definite case of the appellant is that the debts of the company exceeded its paid up capital and that the company is unable to pay even the salary to its staff and unable to meet the current demands. In the circumstances, the appellant submitted before the court that the company is commercially insolvent. It was also pointed out that another creditor, one K. A. Albert, took proceedings for winding up by filing a company petition and the same was withdrawn when the company discharged its debt. On the aforesaid averments, the appellant, invoking the jurisdiction of this court u/s 439(1)(b) of the Companies Act, prayed that the company may be wound up by the court as per the provisions of the Companies Act, for short, "the Act."

4. The company contended that the petition is not maintainable stating that the attempt of the appellant is only to realise the alleged debt by threatening with winding up proceedings against the company. It is submitted that on March 31, 1989, the company owed to the appellant a sum of Rs. 1,26,500 as principal and interest. The respondent-company has paid Rs. 85,000 in all by July 12, 1989, and after the filing of the company petition, the company paid Rs. 25,000 in three instalments. Thus, the company has paid a total sum of Rs. 1,10,000. It was also contended that the appellant was the managing director of the company from August, 1982, till May, 1989. The grievance of the company is that, as the managing director of the company, the appellant has conducted the affairs of the company in a manner highly prejudicial to the company and detrimental to its financial interests. After the appellant relinquished his office as managing director, the company received many complaints from various suppliers of medicines and other items and that large amounts have to be paid to them. The company conducted a verification and it was found that many of the items are missing and did not find a place in the stock register. According to the company, the total value of the missing items comes to Rs. 1,28,900. Further, it is stated that from October 1, 1988, to April 30, 1989, the total cash collection of the company was Rs. 22,13,210.20 but the amount seen remitted to the bank was only Rs. 2,20,102.01. According to the respondent-company, the appellant is bound to give accounts for the missing amount. The company seriously disputed the claim of the appellant and prayed that the petition has to be dismissed.

5. The appellant filed a reply affidavit answering the allegations raised in the counter-affidavit by the respondent-company. The appellant has produced annexure F reply notice sent by the company to the appellant, and annexure G, copy of the notice, sent by the appellant to the company. The appellant submitted that Rs. 80,000 was paid to the appellant by Dr. T. H. Paul in discharge of his personal liability to the appellant and not in discharge of the debt due from the company. The appellant admitted the payment of Rs. 25,000 after the filing

of the company petition. The other averments were denied by the appellant. The allegation that he did not conduct himself properly as the managing director is without any foundation and the dishonest attempt of the company is to extricate itself from proceedings against the company under the winding up provisions of the Act. In short, by the reply affidavit, the appellant denied the allegation against him and reiterated the fact that the company is indebted to the appellant and that the company is unable to pay its debts.

6. The learned single judge considered the materials placed before him and observed that the circumstances of the case revealed that till the company petition was filed on July 17, 1989, the company did not dispute the amount due to the appellant. It was emphasised by the learned single judge that even in the reply sent to the statutory notice (annexure F), there was no dispute regarding the amount claimed by the appellant. Further, the learned judge observed that the company has informed the appellant that the board of directors have decided to pay the debt of the appellant in instalments of Rs. 5,000 per month and also when the financial position of the company improved, the company would increase the amount of the instalment to Rs. 10,000 per month. These facts were found by the learned single judge on the basis of annexure F.

7. We feel that it is apposite to refer to the relevant portions of annexures C, F and G here itself. Annexure G is dated May 25, 1989. It is addressed to the chairman of the company. It is stated in annexure G that the company owes a sum of Rs. 1,30,389.37 and interest of Rs. 44,319.75 as on May 1989, to the appellant. This letter, annexure G, is replied to by the managing director, Dr. T. H. Paul, by annexure F. In the letter to annexure F, the subject noted is "loan of Rs. 1,74,709.16 including interest said to be due to you". The reference in annexure F is to annexure G and another letter dated June 19, 1989 (annexure C). In annexure C, the appellant has made it clear about his debt thus :

"The amount due to me from the company has been advanced to the company from 1980 onwards. Had I invested this amount in Government securities it would have more than doubled by now. Hence, I will be claiming interest at the rate of 15 per cent, per annum on the total amount due to me as on March 31, 1989, viz., Rs. 1,74,709.16 from April 1, 1989, onwards."

8. In annexure F, no dispute is seen to have been made as regards the claim. We say so, since many instances of misdemeanour or rather misconduct are pointed out on the part of the appellant when he was the managing director of the company. No clear denial of the debt due to the appellant is stated in annexure F. But, in fact, certainly we are not making a finding--it appears that the company is tacitly admitting the liability, by saying in the opening paragraph itself thus :

"With reference to your above letters, the board of directors at their meetings on May 8, 1989, as well as on June 24, 1989, has decided to pay you Rs. 5,000 per month and, if and when the financial position permits, to increase the same to Rs. 10,000 per month. Enclosed please find a cheque for Rs. 5,000 as first

instalment."

9. Now, as we see from the counter-affidavit filed by the company, the gravamen of the defence is that the company has paid towards the debt of the appellant Rs. 85,000 and the payment by Dr. T. H. Paul to the appellant of an amount of Rs. 80,000 is a payment by the company. This is an important and controversial point. It is significant that no mention of payment of Rs. 80,000 was adverted to in annexure F. It is also very relevant in the circumstances to note that annexure F is signed by Dr. T. H. Paul as managing director of the company. We feel that annexure F is not a casual reply as is evident from the tone and temper of that document. We have already adverted to the fact that in annexure F many instances of misconduct and misdemeanour of the appellant are pointed out and so, the omission to dispute the total amount due to the appellant as claimed by the appellant assumes great importance. Though the company is disputing now before the court the debt due to the appellant on the ground of discharge, it is difficult to perceive even a long shot pleading of discharge in annexure F. In the counter-affidavit it is clearly admitted that the respondent-company owed to the appellant as on March 31, 1989, a sum of Rs. 1,26,500 towards principal and a sum of Rs. 47,767.25 towards interest totalling Rs. 1,74,267.25. By giving details of the amount as stated above, the respondent-company has in unequivocal terms admitted that the company owed an amount of Rs. 1,74,267.25. So, when once the company admits such a liability, it is for the company to say that the liability has been discharged and that is what is attempted in the counter-affidavit by saying that towards liability, the respondent-company has paid a sum of Rs. 30,000 on April 7, 1989, Rs. 20,000 on April 15, 1989, and Rs. 30,000 on May 5, 1989, and another sum of Rs. 5,000 on July 12, 1989. Of course, in regard to Rs. 5,000 paid on July 12, 1989, now there is no dispute. The total of the other payments would come to Rs. 80,000. The last of the payments (Rs. 30,000) was on May 5, 1989. This date seems to be important, since annexure G is dated May 25, 1989, and annexure F is dated July 6, 1989. When in annexure G, the appellant made a claim for Rs. 1,30,389.37 and interest of Rs. 44,319.75, Dr. T. H. Paul, who has paid an amount of Rs. 80,000 and the last of the various payments is on May 5, 1989, did not make mention of these payments in the reply dated July 6, 1989, of the company signed by the very same Dr. T. H. Paul. We feel that the dates are important. Further, we cannot understand why the company has refrained from producing the receipts issued by the appellant which, in the normal circumstances should be with the company or it can be assumed that the receipts are with Dr. T. H. Paul, who is the managing director of the company and who has filed the counter-affidavit. Normally, the receipts should be in the name of the company. As regards this crucial question, the learned single judge said that the question is important and has to be examined in detail by the appropriate court. Further, the learned single judge said :

"The contention that the payment was on behalf of the company and not on behalf of Dr. T. H. Paul personally, cannot be accepted without further

investigation."

10. True, there is no final finding on these disputed facts by the learned single judge. But the learned single judge has held clearly and plainly that "it has to be held that prima facie the dispute raised is not bona fide". Whether a final finding is required in the circumstances is a question which was very much urged before us by counsel for the appellant. We have to examine this question in the light of the decided cases and the provisions of the Act.

11. Section 433 of the Act deals with the circumstances in which a company may be wound up by the court. Clause (e) of Section 433 provides that a company may be wound up by the court if the company is unable to pay its debts. Section 439(1)(b) of the Act allows any creditor or creditors to file an application before the court for winding up of a company by presenting the petition subject to the provisions of Section 439. Certainly, the ground for winding up raised in this case is that the company is unable to pay its debts. Section 439(1)(b) of the Act tells us when a company shall be deemed to be unable to pay its debts thus : "If a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding five hundred rupees then due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand under his hand requiring the company to pay the sum so due and the company has for three weeks thereafter neglected to pay the sum. or to secure or compound for it to the reasonable satisfaction of the creditor."

12. Annexure C is the notice. In annexure C, the appellant has stated that if the company neglects to pay the amount due to him, within three weeks of the receipt of the notice (annexure C), he will be constrained to file an application before the High Court of Kerala for winding up of the company on the ground that the company has become commercially insolvent and unable to pay its debts.

13. It is admitted that the company has received such a notice. That is evident from annexure F. We have already dealt with the contents of annexure F and noted that the debt is not specifically disputed. But the company has requested only for time to make the payment and one thing is certain that the company has not pleaded the discharge of a substantial portion of debt as now claimed in the counter-affidavit.

14. Palmer in his Company Law (20th edition) referring to the following decisions, *Bowes v. Directors of Hope Mutual Life Insurance and Guarantee Co.* [1865] 11 HL Cas 389, at page 402 (HL) ; *Western of Canada Oil, Lands and Works Co., In re* [1873] LR 17 ; *Chapel House Colliery Co., In re* [1883] 24 Ch 259 ; *Amalgamated Properties of Rhodesia (1913) Ltd., In re* [1917] 2 Ch 115 ; *Accompany, In re* [1950] 94 SJ 369 ; 1 CLC 1406 ; *R. W. Sharman Ltd., In re* [1957] 1 WLR 774 has said : "a petitioning creditor who cannot get paid a sum presently payable has, as against the company, a right, *ex debito justitiae*, to a winding up order". "Ordinarily speaking, where a valid debt, both at law and in equity, is established against a company, it is not, under the Act of 1862, a

discretionary matter with the court to say whether the company shall be wound up or not ; but it is the duty of the court to direct the winding up", vide *Bowes v. Directors of Hope Mutual Life Insurance and Guarantee Co.* [1865] 11 HL Cas 389 . The above decision has been referred to by Palmer in his *Company Law*. In the twenty-third edition referring to the decision, the learned author said: The general rule is that where a petitioning creditor can prove that his debt is unpaid and the company is insolvent it is the duty of the court to direct a winding up and the creditor is entitled to an order *ex debito justitiae*." The above statement that the creditor is entitled to an order *ex debito justitiae* in the context has been explained in *Pritchard, In re* [1963] Ch 502 as a phrase which means no more than that in accordance with settled practice the court can only exercise its discretion in one way, namely, by granting the order. It is profitable to note two more decisions, viz., *P & J Macrae Ltd., In re* [1961] 1 WLR 229 ; *Southard and Co. Ltd., In re* [1979] 1 WLR 1198 . A reading of these two decisions would emphasise the fact that the principles stated in *Bowes v. Directors of Hope Mutual Life Insurance and Guarantee Co.* [1865] 11 HL Cas 389 and *Pritchard, In re* [1963] Ch 502 can be reconciled on the basis that although the matter is "a complete and unfettered judicial discretion" the discretion is exercised in accordance with certain established principles, but the principles do not bind the court in an all or nothing way. In accordance with these principles, the creditor has a *prima facie* right to a winding up order which is subject to certain exceptions." See *Krasnapolsky Restaurant and Winter Garden Co., In re* [1892] 3 Ch 174 *Macrae. Ltd.; In re* [1961] 1 WLR 229

Certainly, we are aware of the thrust of the permissive words of Section 433 of the Act "a company may be wound up by the court". The exceptions to the petitioning creditor's right to an order *ex debito justitiae* directing a winding up by the court includes the defence of raising a *bona fide* dispute as to the veracity of the debt.

16. In *Harinagar Sugar Mills Co. Ltd. v. M. W. Pradhan* [1966] 36 Comp Cas 426, the Supreme Court has adverted to Palmer's *Company Precedents*, Part II, 1960 edition, page 25, and quoted the following passage (at page 430) :

"A winding up petition is a perfectly proper remedy for enforcing payment of a just debt. It is the mode of execution which the court gives to a creditor against a company unable to pay its debts."

17. The Supreme Court also observed (at page 430) :

"It is true that "a winding up order is not a normal alternative in the case of a company to the ordinary procedure for the realisation of the debts due to it" ; but none the less it is a form of equitable execution. Propriety does not affect the power but only its exercise."

18. It is well-settled that "a winding-up petition is not a legitimate means of seeking to enforce payment of a debt which is *bona fide* disputed by the company. A petition presented ostensibly for a winding up order but really to

exercise pressure will be dismissed, and under circumstances may be stigmatised as a scandalous abuse of the process of the court. At one time petitions founded on a disputed debt were directed to stand over till the debt was established by action. If, however, there was no reason to believe that the debt, if established, would not be paid, the petition was dismissed. The modern practice has been to dismiss such petitions. But, of course, if the debt is not disputed on some substantial ground, the court may decide it on the petition and make the order" (emphasis* supplied). Vide Buckley on the Companies Acts, 13th edition, page 451. The above passage has been quoted with approval by the Supreme Court in *Amalgamated Commercial Traders (P.) Ltd. v. A. C. K. Krishnaswami* [[1965] 35 Comp Cas 456 < p> 19. *Ramaswami J. in Syed Murtasa Ali Khan Vs. Stressed Concrete Constructions Private Ltd.,* , considered the question in issue elaborately. When we say the question in issue, we mean only the question of bona fide dispute as to the debt. We feel that the company court is bound to examine whether the defence, viz., the company's dispute as to the existence of the debt is bona fide or not. Finally, after decocting the principles from a large number of decisions, viz., *London and Paris Banking Corporation, In re* [1874] LR 19 444 ; *P.R. Doraiswami Ayyar Vs. Coimbatore Easwara Sahaya Nidhi Ltd.,* ; *Mohammed Amin Bros. Ltd. Vs. Dominion of India and Others,* ; *Rant Ajit Kunuarba v. Rajputana Cold Storage Ltd.* AIR 1955 NUC 4045 ; *Tulsidas Lallubhai Vs. The Bharatkhand Cotton Mills Co. Ltd,* ; *P. Satyarazu Vs. Guntur Cotton, Jute and Paper Mills Co., Ltd.,* ; *T. K. Narayanan v. Alleppey Chamber of Commerce* AIR 1952 TC 435 ; *A Company, In re* [1894] 2 Ch 349 ; *King's Cross Industrial Dwellings Co., In re* [1870] LR 11 149 ; *Vanaspati Industries Ltd. v. Firm Prabhu Dayal Hari Ram* [1950] 20 Comp Cas 311 ; AIR 1950 EP 142 ; *Coalfields of Burma Ltd. v. H. H. Johnson* AIR 1925 Rang 128 ; *Russian and English Bank Ltd., In re* [1932] 1 Ch 663 ; [1932] 2 Comp Cas 424 ; *Bengal Luxmi Cotton Mills Ltd. and Others Vs. Mahaluxmi Cotton Mills Ltd. and Others,* ; *Welsh Brick Industries Ltd., In re* [1946] 2 All ER 197 , the court said (at page 90 of 31 Comp Cas) :

"Bearing these principles in mind if we examine the facts of this case, we find that this is not a case of a bona fide disputed debt. The debt due to the petitioner has been acknowledged till the present winding up petition has been" filed. The respondent-company after again and again begging for time for payment of the debt, has sprung upon the petitioner on the last moment the assertion that the debt is a disputed one. But even now there are no substantial grounds for holding that there is a bona fide dispute. On the other hand, the respondent-company is mysteriously hinting at conspiracies and frauds in the taking over of the assets of the Rayalaseema Constructions and the formation of the present respondent-company and in regard to which they did not examine either Mr. C. P. Venugopal or Mr. Morarka, though opportunity was given to the respondent-company to examine them, if so advised. Therefore, I hold that this is not a case of bona fide disputed debt."

20. We feel that it is an important matter in a petition for winding up by a petitioning creditor to establish the basis of the allegation that the company is

unable to pay its debts. We will be considering the question whether the learned single judge has sufficiently adverted to this aspect of the matter.

21. What is a bona fide dispute largely depends upon the peculiarities of each case. The learned single judge said that the "contention that payment was on behalf of the company and not on behalf of Dr. T. M. Paul cannot be accepted without further investigation". It has to be remembered that this contention that the amount has been paid which, formed a discharge of the debt is not seen taken in the reply to the notice. According to the appellant, the payment is said to be made by Dr. T. M. Paul, in his personal capacity to the appellant. Dr. T. M. Paul is the managing director. He has not been examined. The receipts are not produced. Accounts are not placed before the court. We feel that the court was bound to have an investigation into the matter as to whether the dispute is bona fide or not. We shall advert to certain decisions on this question.

22. In *Wastinghouse Saxby Farmer Ltd., In re* [1982] 52 Comp Cas 479, the Calcutta High Court had occasion to consider a similar question. The court said considering the prima facie evidence placed before it "that there is no material to show that the petitioning creditor was in any way connected with the alleged fraud and collusion which are not only very serious charges but without any material particulars trying to create some suspicion and doubt in the mind of the court if possible. The said allegations appear to be not only absurd and highly improbable but if it is encouraged in this winding up petition, it will be disastrous and open the flood-gates of fraud and collusion and the companies will set up the said plea to defeat the bona fide claims of the petitioning creditors, being merchants and traders, of their money being the price of goods sold and delivered and it will become very easy for any company to set up collusion with the petitioner and the employees of the company in respect of supply of the goods and dispute the claim."

23. In *Durgapur Projects Ltd., In re* [1983] 53 Comp Cas 320 the question of the bona fide nature of the plea was considered. The court observed thus (at page 326) :

"I am afraid that I cannot accept the position from the conduct of the respondent-company. It is clear that the said dispute has not been raised in good faith but only on frivolous, and untenable pleas, if possible, and it is an afterthought which has been set up after the company was served with a statutory notice. In that view of the matter, I cannot but hold that this present winding up petition is not an abuse of the process of the court at this stage and the company is commercially insolvent as it is unable to pay its debt and it is trying to create a cloud by raising frivolous issues and weaving a cobweb, if possible. It is now well-settled that the winding up petition is a legitimate mode of equitable execution and the question is whether in the circumstances of a particular case it should be availed of or not".

24. In *Joti Prasad Bala Prasad v. A. C.T. Developers P. Ltd* [1990] 68 Comp Cas

601 , the Delhi High Court had occasion to consider the plea of bona fide dispute. It held that whether the plea is bona fide or not is a matter for the company court to decide. A reading of the judgment would show that the respondent company has got the obligation when it raises a plea of bona fide dispute of the claim of the petitioning creditor to substantiate it by letting some evidence in the case. Absence of a previous claim (counter-claim) earlier to the presentation of the winding up petition was found in this case. The circumstance that the respondent-company was taking up such a plea in response to the winding up petition which would enable it to try and show that there was a bona fide dispute to the claim of the appellant was held to be without substance.

25. In *Madhusudan Gordhandas and Co. v. Madhu Woollen Industries (P.) Ltd.* [1972] 42 Comp Cas 125, the Supreme Court delineated the principles thus (headnote) : "(i) that the defence of the company is in good faith and one of substance ; (ii) that the defence is likely to succeed in point of law ; and (iii) that the company adduces prima facie proof of the facts on which the defence depends."

26. We feel that keeping in mind the principles laid down by the Supreme Court, an investigation ought to have been done as to the plea of discharge in this case and in that context, the respondent-company ought to have placed more materials before the company court. It has not done so. Only after perusing and examining the materials which could have been produced by the respondent-company to substantiate that there is discharge of a substantial amount, the court is justified in saying that the dispute is bona fide and so, the application is liable to be dismissed even though the company court has made sufficient safeguards for the petitioning creditor to realise the amount if he is entitled to it in a normal appropriate action. We are of opinion that the plea of discharge is a plea which enjoins the person who takes such a plea to adduce evidence and materials before the court at least to satisfy the court prima facie that the plea is bona fide. In this case, as we said earlier, nothing has been brought before the Court in spite of the fact that such a plea has not been raised specifically in reply to the statutory notice. The materials placed before the learned single judge persuaded. His Lordship to hold that "prima facie the dispute raised is not bona fide".

27. Counsel for the respondent submitted that though that finding is detrimental to the respondent, the court would not have arrived at such a finding if some more materials were placed before the court. The respondent has got the accounts and other materials with them. They have not placed it before the court and they must be given an opportunity to place them before the learned single judge so as to disabuse the opinion formed in the case.

28. After holding that prima facie the dispute raised by the respondent-company is not bona fide, the learned single judge considered the matter on a totally different plane and held that no further proceedings for winding up should be ordered for the reason that an immediate winding up will cause considerable

difficulties to the general public. We are of opinion that when a limited company is ordered to be wound up, in almost in all cases it will cause considerable difficulties to the general public. This case cannot be differentiated from other cases and it may not be a valid reason. If the company is commercially insolvent and if no winding up is ordered, it will also cause considerable difficulties to the creditors, shareholders and others and thus to the general public. We do not think that the reason stated in the last paragraph of the judgment of the learned single judge would afford sufficient reason for passing the conditional order made by the learned single judge. Moreover, it has to be remembered that there will be sufficient opportunity for avoiding an order of winding up for the company even if preliminary proceedings are taken as per the provisions of the Companies Act for an order for winding up of the company. The order has to be set aside. We do so and direct that the matter has to be considered afresh on the condition we have made in paragraphs 27 and 28. The petition is remitted to the company court.

29. We are told that an amount of Rs. 50,000 has been furnished as security to the satisfaction of this court though a little delayed. The learned single judge directed that on furnishing security, the appellant will be free to file a suit for recovering the balance amount claimed to be due from the company and that if it is not furnished, orders regarding advertisement of the company petition will be issued. The delay in furnishing security was condoned by the company court. But in view of the appeal, M. F. A. No, 87 of 1990, no suit has been filed. We have already set aside the order of the learned single judge. Since no suit was filed, the security seems to have been withdrawn. Now, since we are setting aside the judgment for a fresh disposal of the application, we feel that it is necessary to direct the respondent-company to furnish security for Rs. 50,000 as ordered by the learned single judge within a month.

30. In case no security is furnished, the direction for a fresh enquiry on the petition will stand cancelled and proceedings for winding up shall be taken by the company court.

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31. In view of the judgment in M. F. A. No. 87 of 1990, no orders are necessary in this appeal. This appeal has practically become infructuous and it is dismissed.