
(1980) 06 KL CK 0020

In the High Court Of Kerala

Case No : Application No. 590 of 1975 in Company Petition No. 17 of 1973

Official Liquidator, Kerala High Court

APPELLANT

Vs

Victory Hire Purchasing Co. (P.) Ltd. and Another

RESPONDENT

Date of Decision : 19-06-1980

Acts Referred:

Companies Act, 1956 — Section 125, 531, 531A

Citation : (1982) 52 CompCas 88

Hon'ble Judges : M.P. Menon, J

Bench : Single Bench

Advocate : T.V. Ramakrishnan, for the Appellant; C.M. Devan and K.N. Parameswaran Pillai, for the Respondent

Judgement

M.P. Menon, J.—This is an application filed by the official liquidator u/s 531 and 531A of the Companies Act for setting aside as invalid two mortgages created by the Wandoof Jupiter Chits (P.) Ltd., in favour of respondents Nos. 1 and 2.

2. The company was ordered to be wound up on December 20, 1973, on a winding-up petition presented on October 1, 1973. The provisional liquidator was appointed on October 11, 1973. Respondent No. 1 is the Victory Hire Purchasing Company (P.) Ltd. (hereinafter called " Victory ") and respondent No. 2 is one V.M.D. Bhattathiripad, its managing director. The two mortgages were registered u/s 132 on December 12, 1973, on the basis of particulars furnished to the Registrar u/s 125, on September 9, 1973. They were created by deposit of title deeds on August 30, 1973, one in favour of " Victory " for Rs. 88,167.17 covering 40 acres of coffee plantation and some other land, and the other, in favour of the 2nd respondent for Rs. 22,855.46 covering over 16 acres of land in Ernad Taluk.

3. The liquidator's case as set out in the application is as follows: It was from the Registrar's office and from the statement of affairs filed by two of the former directors of the company that he came to learn about the mortgages in question. The former managing director had stated that respondents Nos. 1 and 2 had advanced some amounts to the company between 1969 and 1972 and that the

mortgages were created when legal action was threatened. Two of the former directors of the company were also directors of Victory. The 2nd respondent himself was the managing director of Wandoor Jupiter till March 30, 1972. The company had a large number of other creditors. The creation of the charges in favour of a former managing director and in favour of Victory managed by him just one month before the commencement of the winding-up, was an attempt to secure debts which remained unsecured all along. The records of the company did not contain anything to show that the two creditors had exerted pressure ; in fact, there was nothing in them to show that the charges were created at all. It was also not known from where the equitable mortgages were created. Substantially, the whole of the immovable properties belonging to the company were so mortgaged. There were circumstances to infer that respondents Nos. 1 and 2 had managed to get their debts secure when they came to know that the company was insolvent and that the directors of the company had clearly intended to confer an undue advantage on the former. The transactions were not entered into in the ordinary course of business.

4. Respondents Nos. 1 and 2, however, gave a different version in their common counter-affidavit. The 1st respondent (Victory) was carrying on the business of granting loans under hire purchase against motor vehicles, and it had dealings with the company. On April 2, 1972, the company wrote to Victory for a loan of Rs. 1,00,000, and considering the old relationship between the two, the board of Victory agreed "on principle" to grant the loan. The 1st respondent accordingly made a deposit of Rs. 70,252.74 for one year, on April 5, 1972 ; and since it was short of funds, its directors requested the 2nd respondent to make up the balance. The 2nd respondent thereupon made a deposit of Rs. 22,855.46 on the same day, inclusive of other amounts due to him under other accounts. The agreement was that interest on the deposits would be paid every month. Such payments were not, however, made, and after repeated demands, the company issued cheques " which were intended to be payment of interest". These cheques were dishonoured. The respondents thereupon threatened to take civil and criminal action, and the company, in order to ward off such proceedings, agreed to give security. On June 17, 1973, the directors of the company wrote a letter offering such security; and on September 19, 1973, the necessary returns for effecting the registration were forwarded to the Registrar. There were some defects in the return and these had to be got cured before the certificates of registration were issued on December 12, 1973. The mortgages were thus created to secure the amounts advanced in April, 1972, and not the amounts advanced before 1972. The company had other properties besides those charged, and these were assigned to the other creditors under similar circumstances. Respondents Nos. 1 and 2 were not recipients of undue favours. The company was in solvent circumstances at the time the advances were made. It had a fixed deposit of Rs. 1 lakh in the bank, and a fleet of 20 cars. It had opened new branches thereafter and it had also an ambitious project to start a scooter tyre factory investing Rs. 25 lakhs. The company was solvent even at the

time the mortgages were executed.

5. The liquidator filed a reply affidavit asserting that there was nothing in the records of the company to show that any request as alleged was made on April 2, 1972, or that any payment was made on April 5, 1972. The company was also not empowered to borrow such a huge sum. The mortgages were not registered within 30 days of their creation and their registration itself was, therefore, invalid. The company was in insolvent circumstances at the relevant period.

6. On the above pleadings, the following issues were framed :

(1) Whether the documents impugned in the application violate Section 531 and/or 531A of the Companies Act ?

(2) Whether the respondents were creditors of the company and if so for what amount ?

(3) Whether the mortgages relied on by the respondents were validly created in accordance with law ?

(4) To what relief is the applicant entitled ?

(5) Costs ?

A " junior technical hand " attached to the official liquidator's office was examined as P.W. 1, and Exs. P-1 to P-11 were marked on behalf of the applicant. On the respondents' side, the 2nd respondent was examined as R.W. 1 and Exs. D-1 to D-20 were marked.

7. It will be useful at this stage to briefly consider the scope of Sections 531 and 531A. In bankruptcy, the rule is that an individual, in contemplation of bankruptcy, cannot by his own act favour any one creditor so as to defeat the equal distribution of his properties among all. This is recognised, for instance, by Section 54 of the Provincial Insolvency Act which provides for avoidance of all payments, transfers, etc., made by an insolvent in favour of his creditors, " with a view of giving that creditor a preference ". Section 531 of the Companies Act extends the above principle to companies, by placing the winding-up of a company on the same footing as the insolvency of an individual; and its effect is to avoid payments, transfers, charges, etc., made by a company in favour of some of its creditors within six months before the commencement of winding-up, and at a time when it was unable to pay its debts in full, if such payments, transfers, etc., were made with a view to give those creditors preference over the others. The essence of fraudulent preference is thus the giving of an improper benefit to a few, leading to inequality between them and the generality of creditors.

8. Section 531A provides that any transfer of property or goods made by a company otherwise than in the ordinary course of business will be void against the liquidator, if made within one year before the commencement of the winding-up. This again is an adoption of the principle in Section 53 of the Provincial

Insolvency Act. Annulment u/s 531A is possible even in cases where an intent to defect the other creditors is not disclosed. If the consideration for the transfer is grossly inadequate, want of good faith can be presumed. Even if there be valuable consideration, the liquidator may show that the transferee, knowing all the circumstances, which subsequently and soon thereafter, resulted in winding-up of the company, entered into the transaction with a view to shield the assets from the liquidator. If it is seen that the attempt has been to shield the assets against the claims of creditors in general, or to derive an undue advantage for the transferor or the transferee, suggesting that such a transaction could not have been entered into in the ordinary course of business, the transaction will be annulled. The law of insolvency recognises a higher title in favour of the official assignee or receiver than the insolvent himself, so that the former could impeach transactions which the latter himself could not have, had he not been adjudged insolvent. The same rule applies to companies under Sections 531 and 531A.

9. To establish fraudulent preference u/s 531, it is not enough to show that preference was shown to a particular creditor; it must also be shown that it was done " with a view " to give him favoured 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, an assessment of the various motives that animate human conduct, is thus involved ; and as pointed out by Lord Greene M.R. in *In re M. Kushler Ltd.* [1943] Ch D 248 (CA), a state of mind is as much a fact as a state of digestion, and the method of ascertaining it is by evidence and inference. 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, because by giving that benefit, all that is done by the court is to hold that the case against him has not been proved beyond reasonable doubt. Suspicion, however, strong, will not be sufficient; if there is room for more explanation 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 ; when you do something to ward off a threat, you do it for saving yourself, and not for helping the other. Thus, payment of debts by a company under a 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. Where a company had promised to mortgage its property when called on to do so by one who had made advances to it, and the company complied with his request after becoming insolvent, it was held that the mortgage was a fraudulent preference [*Re Eric Holmes (Property) Ltd.* [1965] 2 All ER 333 ; 35 Comp Cas 811 (Ch D)], But in another case *In re F.L.E. Holdings Ltd.* [1967] 1 WLR 1409; [1968] 38 Comp Cas 214 (Ch D), where the mortgage was given under the honest belief that it would be in the interests of the

company to do so and that the company would be able to get further advances from the same creditor by showing good faith, it was held that no fraudulent preference was involved. What matters is the motive ; and if it is found that the company intended to give an improper advantage to one creditor, in the light of all the facts and circumstances disclosed, the transaction will be set aside.

10. Issues Nos. 2 and 3 can first be disposed of, as they do not call for a detailed examination of the evidence in the case. The liquidator admits in para. 7 of the application itself that Victory was a creditor of the company to the tune of Rs. 52,735 as per the sundry creditors' ledger for the year ending December 31, 1972 ; and in para. 5 of the reply, it is also admitted that the 2nd respondent was likewise a creditor for Rs. 70,809.45. He, however, is not sure of the correctness of the relevant entries ; but Ex. P-9 letter, and the entries in the other books made available are sufficient to hold that some amounts were due to the respondents at the relevant time. It is unnecessary to determine what amounts were actually due, since no outright conveyance requiring an investigation into the adequacy of consideration, is involved. If the transaction is avoided, the liabilities will remain as provable unsecured debts, the extent whereof will be decided by the liquidator in appropriate proceedings, and if the charges are held to be valid, then again a separate adjudication of what is due to the respondents will be necessary. It is enough for the present to hold, under issue No. 2, that the respondents were creditors of the company at the relevant time.

11. On the question whether the mortgages were otherwise validly created the first contention of the liquidator is that there was no board decision to seek such a huge loan and that under the articles of association of the company (Ex. P-3) no loan in excess of the paid up capital could have been sought for or obtained without the concurrence of the general body. The paid up capital was only Rs. 49,000; and it is argued that if the incurring of the liability was itself unauthorised, the attempt to secure it should be ultra vires. But p. 62 of Ex. P-1 minutes book shows that on June 19, 1971, the board had decided to receive deposits from others whenever necessary, and p. 98 reveals that the general body meeting held on July 3, 1972, had authorised the directors to borrow funds in excess of the paid up capital. It is a moot point whether this will regularise liabilities incurred prior to July, 1972, but admittedly the charge was created much later, so that, at the time the security in question was given, the action was intra vires. The liquidator's contention on this point should, therefore, fail.

12. The second contention is that there was no valid return filed u/s 125 and that this inherent defect could not have been cured by the mere issue of a certificate by the Registrar u/s 132. u/s 125, the prescribed particulars of the charge together with the instrument by which it is created or evidenced are to be filed with the Registrar within 30 days of its creation ; and the argument is that though the particulars were sent to the Registrar on September 19, 1973, the papers were returned as defective and were not re-submitted within 30 days of

August 30, 1973. It is further pointed out that all the requisite particulars in Form 8 were also not furnished in the return dated September 19, 1973. Exhibits D-15 to D-18 disclose that the Registrar had taken objection to the first return dated September 19, 1973, on the ground that separate returns had to be filed for the two charges and that the number of the instrument, the date and the rate of interest were not entered in the appropriate columns of Form 8. But r. 3 of the Companies (Central Government's) General Rules and Forms, 1956, provides only that the forms in annex. "A" or forms " as near thereto as circumstances admit" are to be filed u/s 125; and it is difficult to hold that any mandatory requirement of Section 125 had been overlooked in this case, particularly in view as the circumstance that the registering authority himself had not declined registration on any such ground. Section 132 itself stipulates that the Registrar's certificate " shall be conclusive evidence " that all the requirements of the statute have been complied with.

13. Exhibits D-12 and D-13, the memoranda evidencing deposits of title deeds, were admitted in evidence subject to the liquidator's objection that they were not registered ; and Sri. T. V. Ramakrishnan contends, on the basis of the Supreme Court's decision in United Bank of India Ltd. Vs. Lekharam Sonaram and Co. and Others, , that if they are inadmissible for want of registration under the Registration Act, the transaction itself cannot be proved by oral evidence. In other words, he contends that no equitable mortgage as contemplated in law was created on August 30, 1973. It is settled law that where title deeds are handed over with an intention to create security, the law implies a contract of mortgage without anything more. But where titles are handed over along with a written bargain, the bargain must rule if it is an integral part of the transaction. When the parties intend to reduce their bargain into writing so that the transaction is incomplete without the document, it is registrable ; on the other hand, where the document is only an evidence of the deposit, it is not compulsorily registrable. Reading Exs. D-12 and D-13 in this background, it appears to me that they do nothing more than create a record of the title deeds handed over. The sum borrowed is not specified. The rate of interest is not mentioned. There is no mention about a mortgage, and there is no declaration that the properties are not otherwise encumbered. In fact, they are much simpler than the document considered by the Supreme Court in the United Bank of India Ltd. Vs. Lekharam Sonaram and Co. and Others, where a declaration had been made that " the deposit will give you a valid legal title over my said properties as mortgagee ". If the Supreme Court still held that the document in question was not compulsorily registrable, it must be much more so in the present case. This contention of the liquidator also, thereto, fails.

14. Issue No. 3 is, therefore, answered in favour of the respondents and against the liquidator, subject of course to issue No. 1.

15. Turning now to issue No. 1 and the circumstances under which the equitable mortgages were created, there is a keen controversy between the parties as to

what liability was sought to be secured thereby, the liquidator contending that the idea was to protect the debts incurred by the company between 1969 and 1972 and remaining unsecured all the While, and the respondents asserting that they were to cover fresh advances made in April, 1972. It may not be necessary to record a definite finding on this question because even if it is found that fresh advances were made in April, 1972, as stated by the respondents, the creation of the mortgages was much later and was admittedly on the eve of winding-up. Even so, some of the aspects highlighted in this connection by counsel for the liquidator deserve notice, as they cast a shadow on other questions which are relevant. The first is that, though Ex. D-5 letter dated April 2, 1972, requesting for a fresh deposit of Rs. 1 lakh makes mention of a board resolution passed by the company in this regard, Ex. P-1 minutes book contains no such resolution. The minutes recorded in this book relate to the period from November, 1968, to December, 1972, and take up only pp. 1 to 114 out of 300, indicating thereby that no minutes at all were drawn up after December, 1972. There was a board meeting on March 30, 1972, during which the resignation of the 2nd respondent from the office of the director and managing director was accepted; and the next recorded board meeting was on April 15, 1972. The minutes of these two meetings do not disclose that any loan was applied for or obtained. Nor does Ex. P-2, day book, show that such advances were received from respondents Nos. 1 and 2. The ledgers (p. 50 of Ex. P-4 and p. 2 of Ex. P-6) also do not reflect receipt of any such amounts. In the normal course of business when a company with a paid up capital of only Rs. 49,000 applies for and obtains a loan of this size from the respondents who were its major creditors even otherwise, one should expect some record of the transaction ; but none is there.

16. Again, the 1st respondent is said to have paid over Rs. 70,000 in cash on April 5, 1972. Normally companies do not make such payments in cash. Exhibit D-20 cash book of Victory no doubt shows a payment of Rs. 70,252.74 to the company on April 5, 1972, but this entry follows two other entries made on April 6, 1972. Many of the pages in this book are seen to be so written up as to leave sufficient space at the bottom for making belated entries. Exhibit D-5 requested the 1st respondent-company to have the matter considered at its next board meeting itself but no board meeting of Victory was admittedly held before payment on April 5, 1972. The 2nd respondent (R. W. 1) would say that the matter was urgent and that he consulted such of the directors who were immediately available; the lender was apparently more aware of the urgency than the borrower ! It is also difficult to understand, notwithstanding the explanation attempted by R. W. 1, how the exact amount of Rs. 70,252.74 came to be paid against a request for Rs. 1 lakh, leaving the 2nd respondent " to make up the balance " by paying the exact amount of Rs. 22,855.46. Exhibit D-10 minutes book of Victory records a board meeting on April 29, 1972, which approved the deposit made on April 5, 1972, on the basis of the request made on April 2, 1972; but this latter date is arrived at after corrections, both in the body and in the marginal heading. These and other circumstances do create a

genuine doubt as to whether any amount was advanced at all by respondents Nos. 1 and 2 on April 5, 1972 ; but I will assume that the respondents' story is true and that the amounts were paid to the company on April 5, 1972.

17. Then about the circumstances under which the mortgages came to be created, R.W. 1 admits that both the company in liquidation and the 1st respondent-company were founded by the same person, the late Sri. Krishnan Namboodiri. The 2nd respondent was the managing director of both the companies till March 30, 1972. Just a day after his resignation as managing director of Wandoor Jupiter, Ex. D-5 request was made, and within three days of the request, the 2nd respondent met it, by using Victory's funds and his own personal funds, " taking into consideration the old relationship between the two companies ". The company in liquidation was indebted to respondent No. 1 to the tune of over Rs. 45,000 at that time, and the 2nd respondent also was a creditor for over Rs. 70,000. R.W. 1 also admits that as on April 5, 1972, three directors of Victory were also directors of Wandoor Jupiter; and Ex. D-10 discloses that one of them, Sri. K. P. Damodaran Namboodiri, who succeeded the 2nd respondent as managing director of Wandoor Jupiter from March 30, 1972, continued to be a director of Victory till November 1, 1973. The office of Victory was also situated in the Jupiter buildings till at least September 29, 1972 (see p. 47 of Ex. D-10). Thus, the two companies had a common founder, the same managing director till March 30, 1972," and a few directors in common all the while. Their offices were housed in the same building for long, and the last managing director of Jupiter continued to be a director of Victory till the equitable mortgages were created on August 30, 1973. ,

18. The respondents' case that the mortgages were created when the company was threatened with civil and criminal action when its cheques for interest were dishonoured, does not stand close scrutiny. If the advances were made on the footing of the letter dated April 2, 1972, that letter itself contained an offer to give adequate security so that there was no need to administer a threat more than a year later for that purpose. That apart, Victory's board resolution dated April 29, 1972 (see Ex. D-10) records a decision " to receive necessary documents for the security of the deposit" and another " to collect the deposit amount either in cash or as property such as buildings, estate or vehicles". This too indicates that the question of security had cropped up at the time of making the advance itself, and not later. A board meeting of Victory held on December 19, 1972, decided to get assignment of decrees obtained by Wandoor Jupiter, in part satisfaction of amounts due. And on March 31, 1973, the board again decided, on the request of Sri. K. P. Damodaran Namboodiri to acquire 40 acres of rubber estate the company was willing to sell in order to wipe off its liabilities to the extent of Rs. 1 lakh. Exhibit D-7 cheque was dishonoured in February, 1973, and if any threat had really been made on that count, the decision taken by Victory's board on March 31, 1973, would have been different. Victory's minutes book shows that the earliest occasion on which its directors had thought about equitable mortgages was in June, 1973 ; and even that decision makes no

mention of the dishonouring of cheques. According to R.W. 1, the threat was administered when Ex. D-7 was returned; he refers to no other cheque, though the counter-affidavit repeatedly refers to "cheques". Exhibit D-7 itself is a cheque issued to the 2nd respondent and not to the 1st respondent-company; but R.W. 1 would have it that it was the dishonouring of that cheque that persuaded the directors of Victory to authorise him and two other directors to threaten civil and criminal proceedings. Exhibit P-9 letter is also of little assistance to the respondents because the advances and the threats referred to therein are different from those sought to be pressed into service by them. The circumstances thus suggest that the story of threat, resting entirely on the interested testimony of R.W. I, cannot be accepted.

19. On June 16, 1973, Victory's board decided to call upon Wandoor Jupiter to give equitable mortgage of immovable properties by way of security. The resolution was passed at the instance of one Subramonian Namboodiri who had attended the board meeting as a representative of Jupiter, and it authorised four directors to discuss the matter and fix up the items of properties to be obtained. On the very next day, Jupiter gave Ex. D-11 undertaking to the effect that it would give a mortgage over 65 acres of coffee estate at Kalpetta and another 16 acres of land at Wan-door. Then comes Ex. D-1, said to be a copy of the resolution passed by Jupiter on August 20, 1973, authorising Sri. K. P. Damodaran Namboodiri to create the mortgage in favour of respondents Nos. 1 and 2. Three title deeds were to be delivered to the first respondent-company to secure the principal of Rs. 70,254.74 and interest thereon, totalling Rs. 88,167.17, and one was deliverable to the 2nd respondent to secure the principal amount of Rs. 22,855.46. (The 2nd respondent was apparently not keen to get interest at 18%) The above is seen followed by a board resolution of Victory (at p. 63 of Ex. D-10) taken on August 25, 1973, authorising the 2nd respondent to receive deposit of the three title deeds at Trichur, in consultation with the advocate, Sri. M. S. Kartha of that place. Exhibits D-12 and D-13, memoranda of deposits, were then apparently drawn up at Trichur on August 30, 1973. According to R.W. 1, the directors of Wandoor Jupiter were lax in the matter of furnishing the requisite particulars u/s 125, and he, therefore, had to take the initiative himself, on September 19, 1973, to send them up to the Registrar.

20. Pausing here for a minute, one has to take note of the contentions urged by counsel for the liquidator in connection with some of the aforementioned documents. It has already been seen that Ex. P-1 minutes book of Wandoor Jupiter contains only blank pages after December 8, 1972, with no recorded board decisions after that date and it is suggested that the genuineness of Exs. D-1, D-11, D-12 and D-13 (all of 1973) is open to doubt. Since the company's records and books for 1972 do not also show anything about the advances said to have been made in April, 1972, the authenticity of Exs. D-5, D-6 and D-9 are also questioned. Exhibit D-1, it is said, cannot be treated as a valid board resolution at all, in view of Sub-sections (1) and (1B) of Section 193. The resolution referred to in Ex. D-5 has not been produced, and Ex. P-1 indicates

that no such resolution had ever been passed. The liquidator had specifically asserted in the application that no decision had been taken by the company to create the mortgages or even to ratify them after creation, and still the respondent's counter-affidavit filed in March, 1976, had made no reference at all to Ex. D-1 dated August 20, 1973. On the other" hand, they had made mention of Ex. D-11 dated June 17, 1973, and produced a copy thereof along with, the counter-affidavit itself. Again, the liquidator had stated that there was no knowing where the equitable mortgages were created, and still the counter-affidavit did not disclose that they were made at Trichur. Exhibits D-1 and D-10 to D-13 were produced only in December, 1978, after the examination of P.W. 1 was completed and the evidence of R.W. 1 had begun, though the respondents had produced one set of documents along with the counter in 1976 and another two sets in November, 1977. There is nothing to show how Exhibits D-1, D-5 and D-11 were delivered to the respondents, and there was no mention of the memoranda of deposit (Exs. D-12 and D-13) in the counter-affidavit. The peculiar manner in which the entry dated April 5, 1972, in Ex. D-20 cash book is seen made has already been referred to, and it is the liquidator's contention that in view of the above circumstances the respondent's case based on the said documents cannot be accepted at all.

21. There appears to be considerable force in the above submissions ; but even ignoring them, what is the picture one gets ? On April 5, 1972, when more than Rs. 45,000 were already due to it, the 1st respondent made a further advance of over Rs. 70,000 to the company making use of almost the last paise it had by way of liquid resources (the bank balances at the time stood at Rs. 207 as per Ex. D-20); and the 2nd respondent, to whom more than Rs. 70,000 was due, also made a further unsecured advance of Rs. 22,000 odd. The arrangement was that interest would be paid every month, but nothing was paid till a solitary cheque for Rs. 5,000 was issued in February, 1973. All that the 1st respondent had done in the meanwhile was to take a decision in December, 1972, to get certain decrees assigned, and another decision in March, 1973, to acquire 40 acres of rubber estate, and that too at the "request " of the borrower. Exhibit D-11 undertaking of June, 1973, related only to the debts due to the 1st respondent : the 2nd respondent had apparently done nothing even by that time to seek security for the amount of more than Rs. 1 lakh due to him. He had not even issued a notice of dishonour in connection with Ex. D-7 cheque. The understanding to give and take the equitable mortgages in question, in any event, was reached only in June, 1973, when there were hardly three-and-a-half months for winding up to commence. And even when the title deeds were deposited in August and steps for registration taken in September, the advances made by the respondents before April, 1972, remained unsecured. As disclosed by annex. " A " to the application and supported by Exs. P-4 and P-5, the company had more than 250 sundry creditors (besides other creditors) as on December 31, 1972, and if the advances said to have been made on April 5, 1972, are also taken into account, the liability under this head alone was about

Rs. 61/2 lakhs. P.W. 1 would say that on a scrutiny of all the books and records of the company, what he found was that it had only two other items of immovable properties at the time of winding up., i.e., 31/2 cents of land at Mavoor and another 43 cents at Wandoor with a building therein; and though the respondents would assert that it had many other items there, is no evidence to support this case. Exhibits D-2 to D-5, assignments executed between June, 1972, and May, 1973, together take in less than 2 acres so that at the time the equitable mortgages in question were made, the items concerned (57 acres; including 40 acres of coffee plantation) represented more than 90% of all the immovable assets the company had. And this was given as security to two out of the hundreds of creditors to whom less than one-sixth of the total debts were due. Favourable treatment at the expense of the other creditors is thus fairly indicated, particularly in the background of the admitted close relationship between the company on the one hand and respondents Nos. 1 and 2 on the other.

22. As observed by Pennycuik J. in the Eric Holmes" case [1965] 2 All ER 333 (headnote); 35 Comp Cas 811, 822 (Ch D):

" Where a creditor making an advance, takes from a debtor a promise to execute a charge at the request of the creditor, the court will, in the absence of any other circumstances, readily infer that the purpose of both parties was to give the creditor the right to be preferred on request, and such an arrangement, although for value, is fraudulent and unenforceable ; and when the debtor in performance of his promise in fact creates the charge at the request of the creditor, the court again, in the absence of any other circumstances, will readily infer that the intention of the debtor is to prefer the creditor. "

When Ex. D-5 letter of the debtor is read along with Victory"s board resolution dated April 29, 1972, a promise to give security at the request of the creditor is clearly deducible ; and when the debtor actually executed the charge just a month before commencement of winding up, at the request of the creditor, the ingredients of the above rule seem to be fully satisfied, unless other circumstances are brought out. Pressure or threat will be some of the " other circumstances", but I have already found that such things were absent in this case. A bona fide hope that keeping good faith would bring in further advances may also be a relevant circumstance, as pointed out in F. L. E. Holdings" case [1967] 1 WLR 1409; [1968] 38 Comp Cas 214 (ChD); but that again cannot be inferred when the case actually set up by the creditors is different, and in view of the admitted circumstance to be presently noticed, that the company had actually folded up its activities within a week of the execution of the mortgages. The inference to be legitimately drawn, therefore, is that the equitable mortgages were given with an intention to give undue preference.

23. The question then arises whether the company was in a position to pay its creditors at the relevant time ; and the sheet anchor of Mr. Devan"s case is that the liquidator has not adduced any evidence to show what the company"s

financial position was at the time the charges were created. The argument, relying on *Jayanthi Bai v. Popular Bank Ltd.* [1966] 2 Comp LJ 36; 36 Comp Cas 854 (Ker), is that there is no direct evidence on the point. In that case, no doubt, the manager of the bank was examined to give a "clear insight" into the financial conditions, and there was no difficulty in finding that the cash balance on hand and the credit balance with other banks stood at a negligible figure, while the borrowings were in the region of Rs. 1,67,000. But that is no authority to hold that without the oral evidence of the ex-directors or ex-accountants of the company, no assessment of the financial position could at all be made. R.W. 1 himself has made two or three significant admissions. He was all along "keen" to help Jupiter, and for this purpose he himself had borrowed from others. On August 30, 1973, the company was having substantial liabilities; and after Onam of 1973, its office was not opened. "It was then" that he decided that steps should be taken u/s 125 for registering the mortgages. Now, the business of the company was in *kuries*; and it was forced to stop it from the 7th or 8th of September, 1973 (Onam holidays), because of its inability to pay *chit* subscribers. Thus, it had proclaimed its insolvency within one week of the execution of the mortgages. A company cannot become insolvent in the course of a day or a week. The heavy liabilities which it admittedly had on August 30, 1973, had wholly paralysed its business activities by September 7, 1973; and if this is so, it requires not much of an inference to hold that it was insolvent on August 30, 1973, or even earlier. The application for registering the charges was forwarded on September 19, 1973, about two weeks after the company had stopped its business and with full knowledge of the situation; in other words, the attempt to get the security registered in order that it may bind the liquidator and other creditors was made not only after the company had become insolvent, but also with full knowledge that it had become insolvent.

24. Going by the books produced also, the picture one gets is of a company moving into the twilight zone even by the end of 1972. As against an interest receipt of Rs. 28,218 during seven months of 1970, the figure came down to Rs. 6,514 for the whole of 1972, while interest payments mounted from Rs. 5,668 to Rs. 63,172 for the same periods (see Exs. P-7 and P-8). A fixed deposit of Rs. 1 lakh available on January 1, 1972, was completely eaten up by the end of 1972 (see pp. 48 and 49 of Ex. P-7). The bank balances as on December 31, 1972 (in six separate accounts) stood at the miserably low figure of Rs. 15,000 odd, as against sundry creditors' liabilities alone, running into lakhs. The paid up capital which stood at Rs. 49,000 on December 31, 1971, was raised by Rs. 12,000 during 1972 by allotting 90 shares to one Padmanabhan Namboodiri and 30 shares to one M.C.S. Nair, appointing then at the same time as directors on monthly remuneration of Rs. 750 each (see pp. 90 to 92 of Ex. P-1 and p. 29 of Ex. P-7). On April 19, 1972, the directors decided to sell the company's vehicles "one by one", and four of them were actually sold in 1972. On December 8, 1972, the board resolved, "to take loans from the staff to stabilise the financial condition of the company" indicating thereby that the condition had become

somewhat unstable by that time. Exhibits P-2 and P-6 show that the ways and means position had become bad by the beginning of 1972 ; the 2nd respondent who was then the managing director of the company was advancing amounts almost every day to keep things going. P.W. 1 who had examined the books and accounts of the company would say that the financial position of the company was bad from the beginning of 1973. Its assets had all been charged, and creditors had sued and obtained attachments. All the vehicles (except one damaged jeep) had been disposed of by the time of the winding up, the statement of affairs making no mention of any such asset. If in spite of withdrawing fixed deposits, selling assets, borrowing substantial amounts and inducting new directors solely for getting some additional funds, the company had found that its position at the end of 1972 required stabilisation by calling for loans even from its employees, and if its cheques had started rebounding at least by February, 1973, the conclusion is inevitable that it was unable to pay its debts by that time.

25. Counsel for the respondents contends that the burden of proof is on the liquidator, and that without his discharging the initial burden, no case could be built up solely on the admissions of R.W. 1. The discussion in the foregoing paragraph, which takes no note of such admissions, answers this contention. That apart, onus, as a determining factor of the whole case, can arise only when the evidence is evenly balanced and the court is unable to take a decision one way or the other without invoking the doctrine of onus; where the preponderance of evidence is all one way, the question of burden does not assume much of an importance (See *Robins v. National Trust Co.* [1927] AC 515 (PC) and *Sime, Darby and Company v. Official Assignee* AIR 1928 PC 77).

26. Two other minor contentions also remain to be dealt with. The first is that there is no plea by the liquidator that the charge was created with intention to prefer the two respondents; but the following averment in the petition furnishes a direct answer :

" In the circumstances it is reasonable to conclude that both the above mortgages were created solely with a view to giving two of its creditors preference over the other creditors at a time when the company was unable to pay its debts as they became due from its funds. "

The second is that some of the entries in the books referred to in para. 24 above have not been got explained through P.W. 1 who produced them. This witness had stated more than once that he was in charge of the work relating to winding up the company, that he had examined its books in that connection, that the petition itself was prepared on the basis of the data gathered from them, and that they disclosed that the company's financial position was bad in 1973. And when those books are produced to substantiate the said case, with an opportunity to the respondents to challenge the data and the inference drawn from them, I think it is legitimate for the court to take note of them. P.W. 1 is only an employee of the liquidator's office, and the records in question were not

being maintained by him. They were being maintained by the company in the usual course of business, and the respondents themselves have been relying on them for other purposes. It is also useful to add that the records referred to include many produced by the respondents themselves.

27. In my view, the following conclusions emerge from the evidence on record:

- (i) security was demanded, offered and given between June and September, 1973, i.e., within the six-month period specified in Section 531 ;
- (ii) it was given to secure debts which were remaining unsecured at least from April, 1972;
- (iii) the company was unable to pay its debts in August, 1973, when the mortgages were created ; if the principle behind Section 434 were to be applied, it had become insolvent by the time Ex. D-7 cheque was dishonoured ;
- (iv) the properties mortgaged bore such a proportion to the residue that it was insufficient to meet the debts of other creditors;
- (v) there was no threat or pressure and there were no other circumstances to exclude an intention to prefer ;
- (vi) the absence of anything in the company's records to evidence the creation of the mortgages or even the borrowing of the amounts, taken along with the admitted close relationship between the lenders and the borrower and the many other circumstances noticed, bring out a dominant motive to prefer the respondents; and
- (vii) the requisite particulars for registering the charge so as to make the mortgages binding on the liquidator u/s 125 were furnished only after the company had stopped its business and with knowledge that it had become insolvent.

Fraudulent preference is thus made out and it is also not possible to believe that the transaction was one made bona fide and in the ordinary course of business. Issue No. 1 has, therefore, to be answered in the affirmative.

28. In the circumstances, the relief prayed for has to be granted, and it is hereby ordered that the two mortgages in question are invalid and are void against the official liquidator. Parties are directed to suffer their own costs.