

(1964) 01 AHC CK 0007
In the Allahabad High Court
Case No : Special Appeal No. 825 of 1962

Raja Sharda Narain Singh and Co.

APPELLANT

Vs

U.P. Oil Industries Ltd.

RESPONDENT

Date of Decision : 08-01-1964

Acts Referred:

Companies (Amendment) Act, 1956 — Section 530(1)
Companies Act, 1913 — Section 230(1)
Transfer of Property Act, 1882 — Section 73

Citation : AIR 1964 All 558

Hon'ble Judges : V.G. Oak, J; Satish Chandra, J

Bench : Division Bench

Advocate : J. Swarup, for the Appellant; A. Banerji, for the Respondent

Final Decision : Partly Allowed

Judgement

Satish Chandra, J.—These two Special Appeals arise out of the same winding up proceedings.

2. U. P. Oil Industries Limited, hereinafter referred to as the Company, was compulsory wound up by an order dated 16-8-1956. The appellant is the holder of the second series of debentures created by the Company under a Debenture Trust Deed dated 23-6-1950. This series consisted of twenty debentures of Rs. 5,000/- each, totalling a sum of Rs. 1,00,000/-. The appellant is recorded in the Register of Debenture Holders as the holder of all the twenty debentures of the second series. It is also admitted that the appellant had paid full consideration, that is Rs. 1,00,000/- for these debentures. These debentures created a charge over the fixed and immovable assets of the Company. The properties which were subject to this charge, were practically the only tangible assets available in the winding up for liquidation of the debts due against the Company. During the course of winding up, the learned Company Judge, by an order dated 4-4-1959 which was passed with the consent of the appellant, directed that the assets of the Mill be sold by public auction free from all encumbrances. The order further

stated that:

"The claim of debenture holders was admitted who consented to the sale being held free of charge provided the amount received by the sale was given to them first"

3. The Mills were on 12-4-1962 sold for Rs. 4,18,000/- free of the charge created by the debentures held by the appellant. On 24-5-1962 the appellant made an application to the learned Company Judge praying that the Official Liquidator he directed to pay the amount of the second series of debentures together with interest on execution of an indemnity bond, or in the alternative to deposit the entire amount of the second series of debentures with interest in fixed deposit with a Bank. The application stated that the charged properties having been sold free from encumbrance, the charge attached itself to the sale proceeds In the hands of the Official Liquidator, and that the appellant having valued his security was entitled ID be redeemed. It was also stated that the Official Liquidator in his report dated 29-4-1959 had held that the appellant was not in actual possession of the debentures and as such was not in a position to give an effective discharge.

4. The Official Liquidator filed a written reply on 9-7-1962. He submitted that in view of the previous decisions in the proceedings, the claim of the appellant was not admitted. It was also stated that the Official Liquidator had from another person received, in June 1963, three debentures of the second series for payment and that it is possible that the other seventeen debentures may also be, in due course, presented for payment. He prayed that the claim of the appellant for payment was liable to be dismissed.

5. The learned Company Judge by his judgment dated 6-9-1962 held that the scrips of the debentures of the second series are not in the possession or control of the appellant, and that the appellant is In the position of a debenture holder whose debenture scrips have been stolen or taken away from him; as such the appellant cannot be treated as a secured creditor, The appellant could not be paid because at any moment the debentures may be presented for payment before the Official Liquidator by some other person. In this view, both the alternative reliefs claimed by the appellant were rejected.

6. Special Appeal No. 825 of 1961 is directed against this judgment, It is urged that the appellant continues to be a secured creditor of the Company and that though he is unable to produce and deliver up for payment the scrips of the debentures, nonetheless he is entitled to payment on giving security to indemnify the Official Liquidator against claims that may be made on the lost debentures.

(6A)) On 17-5-1962 the Official Liquidator submitted a report in Court. Along with it be filed lists of debts due against the Company. In his report the Official Liquidator stated that the appellant as the debenture holder of the second series was not a preferential creditor, but was to be treated as an ordinary creditor. The appellant filed an objection on 8-8-1962 stating that he is a preferential creditor

and the Official Liquidator has erred in treating him as an ordinary creditor of the Company.

7. The learned Company Judge on 18-10-1962 held that the objector is to be treated as an ordinary creditor of the Company and that the creditors mentioned in lists IV and VI of the Official Liquidator, being covered by Section 230, Indian Companies Act, 1913, have a priority over him. The Official Liquidator was, accordingly, authorised to pay the preferential creditors. Aggrieved, the objector has filed Special Appeal No. 826 of 1962. The main contention is that Section 230. Indian Companies Act Is not applicable.

8. Three questions arise for determination in these appeals. Firstly, whether the appellant continues to be a secured creditor; secondly, whether he is entitled to payment and, lastly, whether Section 230, Indian Companies Act is applicable.

9. The question at the threshold is as to the status of the appellant. This question can be examined from two points of views. Firstly, whether the sale of the charged properties, free of encumbrance, changed the status of the appellant; and secondly, whether the loss of the scrips affects his status as a secured creditor. Under the doctrine of substituted security, if the subject of a mortgage or charge is changed or transformed the mortgage or charge attaches to the new form which it had assumed. Section 73, Transfer of Property Act enacts this doctrine.

In its terms, the section applies the doctrine to mortgaged property which is sold to recover arrears of revenue or other charges of the public nature and to compulsory acquisition of such property. The doctrine has been extended and applied to a case of private partition of the property. See *Byjnath Lal v. Ramoodeen Chowdry* 1 Ind App 106 (PC). It has been applied to the case of a charge. In *Union of India (UOI) (Income Tax Officer, Eluru) Vs. Official Liquidator E.M.T. Ltd., Eluru (Official Receiver, West Godavari, Eluru) and Others*, this doctrine was applied to a charge, in winding up proceedings. In that case by a decree a charge was created on thirteen buses belonging to a company. The company thereafter went into liquidation. The Official Liquidator sold four of the buses. It was held that after the sale of the buses, the charge was enforceable against the sale proceeds of the buses.

10. In *Govinda v. Abdul Kadir* AIR 1923 Nag 150 it has been held:

"Where any part of the insolvent's property is subject to a mortgage, the value of the insolvent's right to redeem that property can only be his assets for distribution. If the receiver sells, the property free from the mortgage and realises the purchase money, the whole of it is not assets for distribution but only such part as (sic) is in his hand after paying off the mortgage.""

11. On this principle and in view of the fact that the charged properties were directed to be sold free from encumbrance on the understanding that the appellant shall be paid first out of the sale proceeds, the floating charge under

the debentures held by the appellant would attach to the sale proceeds of the charged properties. The appellant would continue to be the holder of the charge and his status as a secured creditor of the Company would similarly continue.

12. The learned Company Judge has held that since the appellant is not in possession of the debenture scrips and it is unable to deliver them for payment, he cannot be treated as a secured creditor. In our opinion, the production of the scrips is relevant to the question of payment or satisfaction of the debentures, but not to the status of the appellant. The appellant is entered in the company's Register of Debenture Holders as the holder of the debentures of the second series. He has paid consideration for them. His status as a secured creditor of the Company will not depend on his continued possession of the scrips. We are of the opinion that the appellant continues to be a secured creditor of the Company.

13. The second question is whether the appellant is entitled to payment. The finding of the learned Company Judge that the debenture script has been stolen or taken away from the appellant and that he is not in a position to produce and deliver them up, has not been challenged before us. Normally, satisfaction by payment can only be had by delivery of the scrips to the Official Liquidator. Thereby the creditor gives an effective discharge. The question to be determined is whether this rule should be insisted upon in case of a creditor who has lost his scrips or whether the law recognizes some other way of obtaining an effective discharge.

14. Section 229, Indian Companies Act, 1913 makes the rules of the law of insolvency applicable to the rights of secured and unsecured creditors in winding up. It is a basic principle of law of Insolvency that a court or its officer should not insist upon a rule of law when such insistence would produce an unjust result; In *re Thelluson*, ex parte, *Abdy* 1919 2 KB 735 .

15. The debentures of the second series were bearer bonds. They were negotiable by delivery. Section 45A, Negotiable Instruments Act 1881 says:

"Where a bill of exchange has been lost before it is overdue, the person who was the holder of it may apply to the drawer to give him another bill of the same tenor giving security to the drawer, if required, to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again. If the drawer on request as aforesaid refuses to give such duplicate bill, he may be compelled to do so."

16. In the instant case, the appellant applied to the Company for the issue of duplicate debenture scrips. The Company took certain steps in compliance with this request, but before the matter could be finalised it went into liquidation.

17. The law recognizes the situation where the holder of a negotiable instrument may lose it and provides adequate remedy for it namely, that he can ask for a duplicate on giving security to indemnify the drawer against all persons in case the instrument is found again. If the request is refused, he can enforce it by a

suit and obtain a decree therefore. Order 21 Rule 34, C. P. C states that if the judgment-debtor neglects or refuses to obey the decree, the court shall get the document prepared and delivered to the decree-holder

18. If a negotiable instrument is lost, a suit can be founded upon it. Order 7 Rule 16 C. P. C. provides that where ft suit is founded upon a negotiable instrument, and it is proved that the instrument is lost, and an indemnity is given by the plaintiff, to the satisfaction of the court, against the claims of any other person upon such instrument, the court may pass such decree as it would have passed if the plaintiff had produced the instrument in court when the plaint was presented.

19. If in the course of winding up a similar situation arises, the same principle in giving relief ought to be applicable, in the interests of justice and fair play. The appellant is an admitted creditor for value but is unable to produce the scrips. He offers to give security to indemnify the liquidator against the claims of any other person upon the debenture scrips. Sri Jagdish Swarup, learned counsel for the appellant has stated that the appellant is prepared to execute an indemnity bond and to furnish a guarantee from a Scheduled Bank Under the circumstances, the appellant is entitled to payment.

20. The last question relates to the applicability of Section 230 Indian Companies Act Section 230(1). Indian Companies Act. 1913 enumerates various kinds of debts due from the company in liquidation Sub-section 2(b) of the aforesaid section is as follows:

"The foregoing debts shall so far as the assets of the Company available for payment of general creditors are insufficient to meet them, have priority over the claims of holders of debentures under any floating charge created by the Company, and be paid accordingly out of any property comprised in or subject to that charge."

21. It is thus clear that the debts mentioned in S 230(1) have a right of preferential payment as against the claims of the holders of debentures under any floating charge created by the Company; and that those debts can be paid out of the property which is subject to the floating charge The debts mentioned in lists IV and VI of the Official Liquidator have, with one exception, been found by the learned Company Judge to be covered by Section 230(1), Indian Companies Act. The payment or these debts cannot be resisted by the holders of debentures creating a floating charge.

22. Learned counsel for the appellant contends that the Trust Deed whereunder the debentures of the second series were issued, did not create a floating charge but had created a sort of hybrid charge.

23. In Governments Stock v. Manila Rly. 1897 AC 81 at p. 86 Lord Macnaghten described a floating charge thus;

"A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition it

happens to be from time to time. It is of the essence of such a charge that It remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour of the charge is created intervenes

24. A Bench of this Court in the case of Major Anthony Ulysses John and Others Vs. Seth Suraj Bhan and Others, quoted with approval the Following observations of Lord Macnaghten in *Illingworth v Houlds worth* 1904 AC 355 at p. 358: .

"A specific charge is one that, without more, fastens on ascertained or definite property or property capable of being ascertained and defined; whereas a floating charge is ambulatory and shifting in its nature hovering over and, so to speak, floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.

25. Palmer''s Company Law. Twentieth Edition, at page 399 says:

"the property which is subject to the floating charge can be dealt with by the company without consulting the holder of the charge, and may be sold, exchanged or otherwise dealt with in any way that the directors may think fit Upon the happening of certain events, which are set out in the charging deed the floating charge becomes fixed or in technical terminology, it "crystallises"

20. A floating charge thus has two main ingredients. It attaches itself on a group of properties as they may be from time to time. In the second place, the Company is free to deal with the properties charged as it may think fit in the ordinary course of its business, without any hindrance from the holder of the charge.

27. In the instant case, the debentures of the second series issued by the Company mentioned that they have been issued subject to the condition that they will rank as second mortgage upon the charged property of the Company and that

"the said charge shall constitute a floating security only, not binding any sale or other dealing in the ordinary course of business by the Company with the assets or property comprised to the charge"

The debenture trust deed under which the debentures held by the appellant were issued, in paragraph 4 states that "the trustee shall stand possessed of mortgage premises upon trust to permit the Company to carry on the business therewith and to deal with and dispose of the some in the ordinary course of the Company''s business and to pay dividends out of profits..... A perusal of the debenture trust deed, at also the form of debenture annexed thereto does not disclose that the charge sought to be created was either fixed on any property of the Company of that In its nature it was different from a floating charge as ordinarily understood. In our opinion the appellant holds debentures creating a floating charge simpliciter.

28. Sri Jagdish Swarup faintly suggested that there can be no floating charge over Immovable property of a company. The following statement relating to the nature of a floating charge in Palmer's Company Law, Twentieth Edition, page 399 is apposite:

"It will normally be upon the whole of the company's property, including any which is subject to a fixed charge, but it can be restricted to a limited class of property,....."

No principle or case justifies this submission of learned counsel and we are unable to accept it.

29. In the result, the appellant is a secured creditor entitled to payment, but he is postponed to the creditors mentioned in Section 230(1), Indian Companies Act 1913. In this view. Special Appeal No. 826 of 1962 is dismissed.

30. Special Appeal No. 825 of 1962 is allowed in part. The judgment is set aside and the matter is remanded to the learned Company Judge. On executing an indemnity bond and on furnishing a guarantee from a Scheduled Bank, the appellant shall be entitled to payment. The Scheduled Bank shall guarantee immediate payment into Court of such sums as the learned Company Judge may direct in respect of the debentures of the second series which may hereafter be presented and found entitled to payment. The guarantee shall extend to the payment in the aggregate of such sum as is actually to be paid to the, appellant. The guarantee shall last for such a period of time as the Court may fix having regard to the period of limitation applicable to claims that may be made on the Debenture scrips of the second series. In the circumstances, the parties shall bear their costs of both the appeals.