

(1927) 03 AHC CK 0023
In the Allahabad High Court

Union Indian Sugar Mills Co. Ltd.

APPELLANT

Vs

Brij Lal Jagannath

RESPONDENT

Date of Decision : 16-03-1927

Acts Referred:

Citation : AIR 1927 All 426 : (1927) ILR (All) 728

Hon'ble Judges : Mukerji, J

Bench : Division Bench

Final Decision : Dismissed

Judgement

Mukerji, J.—This is a claim against the Union Indian Sugar Mills Co. Ltd., in liquidation, by one Rai Bahadur Brij Lal of Ludhiana and his partner Jagannath, seeking their entry on the schedule of creditors to the amount of Rs. 60,000. They base their claim on a judgment, said to have been passed on foot of a compromise, by the Subordinate Judge of Ludhiana on the 10th of March 1926. The claim was opposed before the official liquidators by Lala Devi Dat, the late managing director of the company. The official liquidators, after examining the claim, allowed it in respect of three sums of money, viz., Rs. 25,000 principal sum, Rs. 1,750 interest and Rs. 500 as "office expenses". They disallowed the rest of the claim. Thereupon the claimants filed their application in this Court, asking it to try their claim. The official liquidators have contested it.

2. The claim was based briefly on the following facts. On the 26th of December 1923, the firm of Brij Lal was appointed the sole agent of the Union Indian Sugar Mills Co. Ltd., within certain tracts of the Punjab. An agreement in writing was drawn up. Under the terms of the agreement, the firm of Brij Lal made a deposit of Rs. 25,000 with the company and received certain privileges in selling sugar manufactured by the company. The firm of Brij Lal, Jagannath was to get a certain interest on their money and they were to receive, besides brokerage, a commission of 1% on the value of sugar sold by them. This commission was, later on, increased to 1 1/4%. The claimants gave a notice to the company, on the 1st of July 1925, stating that the company were responsible for various

breaches of covenants made by them, that the firm had suffered damage and that the damages and the principal money deposited amounted to Rs. 1,00,000. Thereafter, on the 23rd of December 1925, the firm of Brij Lal instituted a suit which was afterwards numbered as 2 of 1926 in the Court of the Subordinate Judge of Ludhiana. The suit was decreed under circumstances to be detailed hereafter and, as already stated, a decree was passed on the 10th of March 1926. The claimants' contention is that the decree is conclusive of their title to get the amount claimed.

3. The official liquidators were of opinion that the decree was not conclusive and the claimants were bound to put their original claim before them so that they might see how far it was justified.

4. When the claim of the firm of Brij Lal, Jagannath came for consideration in this Court the position taken up by the official liquidators was the same as was taken up by Lala Devi Dat before the official liquidators. Their case is that the Court at Ludhiana had no jurisdiction to entertain the suit, that the claim for damages was altogether false, and the decree based on an alleged compromise was obtained by adducing perjured evidence before the Court. The official liquidators deny that there was any compromise at all. Their further contention is that decree or no decree they were entitled to call upon the claimants to establish their title to damages and the amount to which they were entitled before them.

5. In view of these pleadings, the following four issues were framed by the Court. The issue No. 4 was added subsequently, the first three issues having been framed in the first instance:

1. Whether the decree passed by the Ludhiana Court was passed without jurisdiction?

2. Whether the compromise decree was obtained by the claimants by exercise of fraud on the Court?

3. If Issues Nos. 1 and 2 are decided against the claimants, whether they are entitled to any and what damages?

4. Whether in the circumstances of the case the compromise was to the material disadvantage of the company and therefore the compromise, even if honestly entered into by Lala Devi Dat on behalf of the company, is not binding on the official liquidators?

6. It may be stated at the outset that it was originally thought expedient to try the first two issues together and the third and fourth issues also together but after the decision of the Issues Nos. 1 and 2. But in the course of the argument it became abundantly clear that the main question between the parties was involved in the Issue No. 4. The question of law involved in it was argued thoroughly before me and I have decided to record my finding on this issue as well. Dr. Katju has intimated to the Court that he reserves his right to re-argue the Issue No. 4 in the light of such further evidence as may be adduced in the

course of the trial of Issue No. 3. (Then after deciding the Issues Nos. 1 and 2 in favour of the claimants His Lordship proceeded with Issue No. 4 and continued). The whole question that really arises in this case is whether the decree obtained by the firm of Brij Lal, Jagannath is conclusive as to their title to damages and to the amount thereof, or whether the official liquidators can put the decree aside and call upon the claimants to establish their claim before them. The law on the point seems to me to be abundantly clear both on principle and on authority.

7. The company in this case must be and has been throughout treated as an insolvent company. There can be no doubt that it was in an insolvent condition and was unable to pay its debts which amounted to nearly Rs. 10,00,000. The winding up order was obtained by a firm of creditors, Messrs. Moti Lal Ram Kumar, whose claims amounted to over Rs. 3,00,000. Frantic efforts were made on behalf of Lala Devi Dat, the managing director, to obtain financial assistance, to tide over the difficulty but he failed. The premises of the company and the machinery were all mortgaged to the Imperial Bank of India. There can, therefore, be no doubt that this was a case of an insolvent company. The case of an insolvent company and the case of an individual who is declared an insolvent are on the same footing in the eye of the law. The official receiver, in the case of a person who is adjudged an insolvent, the trustee in bankruptcy, as he is called in England, and the official liquidator of an insolvent company, stand on the same footing. They are not the representatives of the insolvent, the individual or the company. On the one hand they represent the estate of the insolvent; on the other hand they represent the interest of the whole body of creditors. The duty of the trustee in bankruptcy or the official liquidators is to distribute the assets of the insolvent, individual or the company, among such of their creditors as have a just claim. Such being the case, the decree that may be valid and binding on the insolvent is not, necessarily, valid or binding against the trustee in bankruptcy or the official liquidator. It is necessary to elaborate the point. I will quote the provisions of the law before further discussing the question. u/s 229 of the Indian Companies" Act of 1913:

In the winding up of an insolvent company the same rule shall prevail and be observed with regard to the respective rights of secured and unsecured creditors and to debts provable, etc., etc., as are in force for the time being under the law of insolvency with respect to the estates of persons adjudged insolvent....

8. u/s 34(2) of the Provincial Insolvency Act

all debts and liabilities to which the debtor is subject when he is adjudged an insolvent...shall be deemed to be debts provable under this Act.

9. It is clear the debts have to be "proved" by claimants before they can expect to be entered in the schedule of creditors. The proceedings in liquidation and the proceedings in insolvency are entirely in the nature of equitable proceedings. A company or an individual is unable to pay its or his debts, the matter is brought before the Court, the Court takes possession of the assets of the insolvent party

and directs that all the creditors, should be treated justly and equitably. Such being the jurisdiction of the Court, it stands clear to reason that nobody has a right to claim more than is justifiably due to him, on the mere ground that the insolvent, the individual or the representatives of the insolvent company had agreed to pay to the claimant more than what was justly and properly due to him. Nobody, on either side, has really contested this proposition of law which has received the support of eminent jurists, as I shall presently show. The whole question is whether the decree is to be received as conclusive evidence of the liability of the company or whether it is open to the official liquidators to say that they would not listen to the decree but would ask the claimants in the present case to adduce evidence as to the truth of their claim. On the principle enunciated, it seems to me to be abundantly clear that the decree cannot be conclusive. The decree may be binding on the company and anybody, representing the company, may be bound by it. But the official liquidators are not the company nor the representatives of the company. They may very well say:

It is true that the decree is binding on the company and Lala Devi Dat by his compromise could bind the company, but, in the circumstances of this particular case, we shall not look into the decree and treat it as a conclusive evidence of your right to receive damages to the sum of Rs. 33,000.

10. On the authorities which I shall quote presently, it seems that the decree is not binding in certain cases, though it may be binding in others. The principle seems to be this.

11. Where there has been a genuine contest between a claimant or a creditor on the one hand and an individual who is subsequently declared an insolvent or a company which goes into liquidation later on and the parties have fought out the case, bona fide, it should not be open to the receiver or the official liquidator to re-open the case and to have, as it were, a fresh trial of strength. The reason is obvious. The Court has applied its mind. The parties have adduced their evidence. Such being the case, it would be a matter of extreme regret if a bona fide trial should be set aside on the sole ground that the receiver or the official liquidator is not bound by the decree. But, on the other hand where the decree rests on something less than a real trial on the merits of the case the question would arise whether the receiver or the official liquidator would not be justified in putting the decree aside and asking for what has been called the "consideration for a judgment." Where a judgment is obtained on the confession on the insolvent, it has been held that it is open to the trustee in bankruptcy to set apart the decree and to ask for proof of the claim. The reason is clear again. The admission of the insolvent may be binding on him but it would not furnish proper proof of the correctness of the claim, to a party, who is not bound by the admission. In this particular case before me the decree does not stand at anything higher than an admission on the part of Lala Devi Dat that damages are really payable to the claimants and that the total amount should be at the figure of Rs. 33,000 and odd. There has been no trial by a Court of justice of the case

and the official liquidators who have to distribute the assets of the company equitably, may very well say:

There is no doubt about the admission of Lala Devi Dat as to the justness of the claim, but we will not accept that admission and we call upon you, the firm of Brij Lal Jagannath, to show to us that your claim is just and equitable.

12. It has been repeatedly remarked that for many purposes (except its binding character on the parties) a compromise decree does not stand at a higher level than a private agreement between the parties. The remark is true undoubtedly. u/s 34(2) of the Provincial Insolvency Act, all such debts are provable as accrued due before a person was adjudicated insolvent as also all such other debts to which the insolvent may become subject by reason of any obligation incurred before the date of such adjudication. In this case the winding-up order, although passed in June 1926, relates back to the 7th of January 1926 when the application for winding-up was made (see Section 168 of the Companies' Act). The company, therefore, was adjudged insolvent, as it were, with effect from the 7th of January 1926. In the circumstances, only such debts are provable against the company as accrued due before the 7th of January 1926 and such other debts as became payable owing to liabilities incurred before the 7th of January 1926. It follows that any liability that was incurred after the 7th of January 1926 cannot be treated as creating a debt provable under Sub-section 2 of Section 34 of the Provincial Insolvency Act. The result would be that while no harm would be done to the claimants' claim, as it stood on the date of the institution of their suit it is not open to them to prove the contract (the compromise) on foot of which the decree was made on the 10th of March 1926. On principle and on statute law, therefore, the claimants cannot ask the decree in their favour to be treated as conclusive.

13. A large number of cases has been cited and discussed before me. I would not discuss all of them in this judgment, I will content myself with discussing just a few of the more important cases.

14. One of the oldest and leading cases and often quoted is the case of *Ex parte Kibble, in re Onslow* [1875] 10 Ch. D. 373. It was held in that case that the Court of bankruptcy could look into the "consideration for the judgment". In this case an infant, before the passing of the Infants' Relief Act of 1874, gave a bill of exchange, payable after his majority, to a jeweller in payment for jewellery. After his majority and after the Act came into operation, the creditor obtained judgment by default against him in an action on the bill of exchange and then took out a debtor's summons, and, on his failing to comply with it, filed a petition for adjudication against him. The question arose whether the applicant was such a creditor as was entitled to obtain an order of adjudication. The creditor relied, on the judgment he had obtained; but it was held that the Court in bankruptcy was entitled to "look into the consideration" for the judgment". Sir W.M. James Lord Justice said:

It is the settled rule of the Court of bankruptcy, on which we have always acted, that the Court of bankruptcy can enquire into the consideration for a judgment debt. There are obviously strong reasons for this because the object of the bankruptcy laws is to procure the distribution of a debtor's goods among his just creditors. If a judgment were conclusive a man might allow any number of judgments to be obtained by default against him by his friends or relations without any debt being due on them at all; it is therefore necessary that the consideration of the judgment should be liable to investigation.

15. The italics are mine.

16. This, as I said, is one of the leading cases on the point. This case was decided in 1875, but as late as in 1907 it was found to possess its full vigour.

17. In the case of *in re Van Laun, ex-parte Chatterton* [1907] 2 K.B. 23 the head-note runs as follows:

No judgment recovered against the bankrupt, no covenant for payment given by or account stated with him, can deprive the trustee in bankruptcy of his right and duty to investigate the nature and grounds of the claim made against the bankrupt's estate: the trustee is, therefore, entitled to go behind these forms and to require satisfactory evidence that the debt on which the proof founded is a real debt.

18. In this case the question arose whether the trustee in bankruptcy could go behind a mortgage and accounts by requiring particular and settled vouchers before admitting the proof of the amount claimed. (By analogy the question in this case is whether it is open to the official liquidators to go behind the contract, between Lala Devi Dat and the claimant firm the shape of the compromise, by requiring particulars and vouchers before admitting the proof of the amount claimed). Cozens Hardy, Master of the Rolls, at p. 29, delivered himself as follows:

The trustee says you are a person who comes in to prove a debt. It is my duty to see that this bankrupt's assets are distributed amongst those who are justly legally and properly creditors of the estate. In order to enable me to do my duty, I ask you to furnish me with such information as will enable me to do that which I am told to do by Rule 22 in the second schedule to the Act, to examine every proof and grounds of the debt.

19. At another place, the learned Master of Rolls quoted from the judgment under appeal of Bigham, J. as follows:

The trustee's right and duty, when examining a proof for the purpose of admitting or rejecting it, is to require some satisfactory evidence that the debt on which the proof is founded is a real debt. No judgment recovered against the bankrupt, no covenant given by or account stated with him, can deprive the trustee of this right. He is entitled to go behind such forms to get at the truth and the estoppel to which the bankrupt may have subjected himself will not

prevail against him.

20. The great authority on Company Law, viz., Lord Justice Buckley, agreed with his judgment and remarked (see p. 31) as follows:

It is well settled that the Court can enquire into the consideration for a judgment debt. A courageous argument has been addressed to us that a debt which has not resulted in a judgment stands upon a more firm basis than a debt which has. The mere statement of that proposition occasions surprise. I do not think it is true. Whether the creditor alleges that there has resulted and that he relies upon an account stated, or a covenant entered into by the debtor, or a judgment which he has obtained, the principle, I apprehend, is exactly the same, and is this that the trustee is not the person who has stated the account, is not the covenantor, is not the judgment-debtor, but is entitled to say "it is my business to see that those who seek to rank against this estate are persons who are really creditors of that estate." If there be a judgment it is not necessary to show fraud or collusion. It is sufficient, in the language of Lord Esher, to show miscarriage of justice, that is to say, that for some good reason there ought not to have been a judgment. Exactly the same, I think, is true of an account stated or of a covenant.

21. In the case of *in re Fraser, ex parte Central Bank of London* [1892] 2 Q.B. 633, the headnote is as follows:

Upon the hearing of a Creditor's petition for a receiving order against a judgment-debtor, the Court of bankruptcy has power, at the instance of the debtor himself, to go behind the judgment and to enquire into, the Validity of the debt, even though the debtor; has previously applied in the action to set aside the judgment, and his application has been refused, and the refusal affirmed by the Court of appeal.

22. To some extent the facts of this case and the facts of the case before me are similar. John Fraser was a debtor, against whom the Central Bank of London presented a bankruptcy petition. The judgment was obtained by the bank against a partnership firm and against John Fraser as one of the partners. John Fraser applied to set aside the judgment as against him and to allow him to defend the action. The Court refused his prayer and an appeal failed. The failure of the application and the appeal was on the ground of delay and on some other grounds, On these facts Lord Esher, Master of the Rolls, said:

As a matter of law the judgment, therefore, stands as a good judgment against John Fraser and it cannot be questioned by him in any Court, except the Court of bankruptcy. But when it is sought to obtain a receiving order against him in respect of the judgment debt, the Court of bankruptcy has to exercise its discretion and for the exercise of that discretion one rule of conduct is to be found in Section 7 of the Bankruptcy Act, 1883, which provides, by Sub-section 3 that if the Court is not satisfied with the proof of the petitioning creditor's debt, or of the act of bankruptcy, etc., etc., the Court may dismiss the petition. The

question is whether the Registrar had not a discretion u/s 7 and whether he has rightly exercised that discretion. The mere fact that there is a judgment for the debt does not prevent the Registrar from saying that there is no good petitioning creditor's debt. The Court of bankruptcy can go behind the judgment, and can enquire whether, notwithstanding the judgment, there was a good debt...may enquire, even at the instance of the debtor, whether there is any ground for making a receiving order.

23. I may point out that in the Indian law the corresponding section to Section 7 of the Bankruptcy Act of 1883 is Section 25 of the Provincial Insolvency Act of 1920. Under this rule of law the petitioner must satisfy the Court with proof of his right to present the petition. In the same case Lord Justice, Kay said as follows:

It is old law in bankruptcy that, neither upon an attempt to "prove a debt, nor upon a petition for an adjudication of bankruptcy or a receiving order against a debtor, is a judgment against him for the debt conclusive. In *ex parte Bryant*, Lord Eldon said "Proof upon a judgment will not stand merely upon that, if there is not a debt due in truth and reality, for which the consideration must be looked to." Can this judgment be treated as conclusive in bankruptcy because the debtor has unsuccessfully attempted to set it aside? I think not, and I cannot see how the matter is any more *res judicata* because there has been an unsuccessful appeal to this Court.

24. The same view was taken in the case of *ex parte Lennox*, in *re Lennox* [1885] 16 Q.B.D. 315.

25. In the case of *in re Flatau, ex parte Scotch Whisky Distillers Ltd.* [1888] 22 Q.B.D 83. relied on by Mr. O'Connor, the case of *ex parte Lennox* quoted above was distinguished. It was held that as a matter of course the Court of bankruptcy will not enquire into the validity of a judgment debt, but only when there is evidence that the judgment was obtained by fraud or collusion or when there has been some miscarriage of justice. In this case the judgment was obtained after a trial of the action by Mathew, J. with a jury. The act of bankruptcy alleged was non-compliance with a bankruptcy notice in respect of the judgment debt. The question arose whether, in the circumstances, it was open to the debtor to impeach the judgment and call upon the Registrar to go behind the judgment and to look into the consideration of it. Lord Esher, Master of Rolls, was of opinion that, in the circumstances of the case, it was not open to the judgment-debtor to go behind the judgment. He delivered himself as follows at p. 85:

Another point was taken-viz., that although an action has been tried by the proper tribunal, a Judge alone or a Judge with a Jury, and definite issues have been thoroughly tried out, and decided against the debtor, and judgment has been given against him accordingly, he against whom the judgment has thus been given, without his being able to suggest that there was any miscarriage of justice of the trial, is entitled to go into the Court of bankruptcy, and, even

though he has appealed against the judgment, assert that the action was not properly tried, and say to the Registrar," you must try every one of the issues over again upon the same evidence if I choose, or upon new evidence, and you have no discretion in this matter." It is not necessary now to repeat that when an issue has been determined in any other Court, if evidence is brought before the Court of bankruptcy of circumstances tending to show that there has been fraud, or collusion, or miscarriage of justice, the Court of bankruptcy has power to go behind the judgment and to enquire into the validity of the debt. But that the Court of bankruptcy is bound in every case as a matter of course to go behind the judgment is a preposterous proposition.

26. In discussing the principle, I have already stated that where a judgment has been obtained, after a trial of issues by a Court, where there has been a bona fide litigation, the trustee in bankruptcy or the official liquidator, in the case of an insolvent company, will not ordinarily go behind the judgment and try to look into the consideration for the same. The reason is clear. The matter has been already threshed out between the parties and there is no reason to suppose that the judgment has not been fairly obtained. But where there are circumstances justifying the trustee in bankruptcy or the official liquidator to doubt the bona fides of the judgment or there are circumstances to show that there has been a miscarriage of justice, it would be open to them to call for fresh proof of the claim. The case under discussion therefore is clearly distinguishable from the case before me. In discussing the facts. I shall presently show that the judgment was given under circumstances which should not bind the hands of the official liquidators.

27. In the case of *in re Hawkins, ex parte Troup* [1895] 1 Q.B.404 the petitioning creditor relied on a compromise decree. The question arose whether a decree, as it stood, was good enough to entitle the petitioning creditor to an order of adjudication or whether the bankruptcy Court had the power to reject the judgment and to enquire into the transactions leading up to the compromise and the judgment. There was a difference of opinion and the learned Judge of the Court of appeal decided against the petitioning creditor in the majority of two to one. Lord Justice Rigby's was the dissentient judgment and Mr. O'Connor relied upon the same. I have discussed the principles and I have quoted authorities. After that, I do not think it is necessary for me to discuss the remarks of Lord Justice Rigby in detail. It is sufficient to say that a judgment would always give a prima facie proof of a debt. It is only when there are circumstances casting doubt on the correctness of the debt, as proved by the judgment, that the judgment may be set apart and independent proof may be called for. There may be cases, therefore, where the compromise was entered into under circumstances which stand unimpeached and, in such cases, the compromise decree may furnish conclusive proof of the debt.

28. The law standing as indicated above, I have to enquire whether the official liquidators were bound to accept the judgment as conclusive in favour of the

claimants or whether they were justified in going behind the judgment and in asking for proof of the "consideration for the judgment." (His Lordship then discussed the evidence and proceeded). On the fact of circumstances, the claim, even if partially correct, was a highly exaggerated one and the compromise was arrived at, if one was at all arrived at, under circumstances which would go to show that Lala Devi Dat was not a free agent, and, at any rate, was not looking to the interest of the company as a man at arm's length towards the claimants. If Lala Devi Dat agreed to the terms of the compromise in the hope that by sacrificing a few thousand rupees in favour of the claimants, he would be able to reconstruct the company and to save it from the dire disaster of liquidation, it cannot be said that the consent was freely given, when, as a matter of fact, the claimants rendered no assistance to the reconstruction of the company.

29. For the foregoing reasons of fact and law (see pp. 14 and 15 of this judgment), I am clearly of opinion that there are circumstances which thoroughly justified the official liquidators in rejecting the claim of the firm of Brij Lal, Jagannath as based on the compromise decree and to call upon them to submit fresh proofs of their claim. (The rest of the judgment is not useful for this report).