

Karnataka Bank Ltd. Vs. Craft Tools P. Ltd. (In Liquidation)

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Court : Karnataka

Decided On : Dec-17-1984

Reported in : [1986]60CompCas229(Kar); ILR1985KAR605; 1985(1)KarLJ247

Judge : M.P. Chandrakantraj Urs, J.

Acts : [Companies Act, 1956](#) - Sections 446(2)

Appeal No. : Company Application Nos. 617 and 646 of 1982

Appellant : Karnataka Bank Ltd.;dr. H. Job and anr.

Respondent : Craft Tools P. Ltd. (In Liquidation);mysore Tools Ltd. (In Liquidation)

Advocate for Def. : S. Vijayashankar, Adv.

Advocate for Pet/Ap. : Udaya Holla, Adv. in C.A. No. 617 and ;Kadidal Manjappa, Adv. for ;H.S. Dwarkanath, Adv. in C.A. No. 646

Disposition : Applications rejected

Judgement :

Chandrakantraj, J.

1. These two applications under Section 446(2)(b) of the [Companies Act, 1956](#) (hereinafter referred to as 'the Act'), are disposed of by the following common

order as a common question of law arises for consideration in both the applications. The applicant in C. A. No. 617 of 1982 is the Karnataka Bank Ltd., a banking concern incorporated under the Banking Companies Act. It is represented by its manager at the Harihar branch who is also its duly authorised power of attorney holder. The applicant-bank claims to be a secured creditor of the respondent, M/s Craft Tools Pvt. Ltd., which has been ordered to be wound up by this court. The respondent is represented by the official liquidator who is the liquidator of the company in question. The bank claims to have advanced a little over Rs. 9,74,259.04 as promote loans in certain sums on four hypothecation deeds in respect of machinery and stock-in-trade. The prayer in the application is that the official liquidator may be directed to hand over all movables situated in the factory premises of the company in liquidation at Harihar including the machinery and stock-in-trade which is said to be hypothecated under the four hypothecation deeds to the bank. Alternatively, it is prayed that the court may cause the sale of the said movables and machinery hypothecated with the bank and direct the amount to be paid to satisfy the loans of the petitioner's bank on priority, as it is a secured creditor.

Similarly, in C. A. No. 646 of 1982, the applicant is one Dr. H. Job and the respondent is M/s Mysore Tools Ltd., which is also now in liquidation. In that application, the petitioner. Dr. H. Job, has prayed for an order directing the official liquidator to give custody of the machinery and other materials which are said to have been hypothecated to him under a deed of hypothecation by the respondent, M/s Mysore Tools Ltd. The amount claimed is Rs. 4,34,280 together with interest, etc.

2. It is useful to state that in both the applications, the applicants have made it clear that they wish to stand outside the winding up proceedings.

3. The question is whether the official liquidator who is now in charge of the assets of the companies in liquidation is liable to give possession of the hypothecated goods to the respective secured creditors of the two companies in liquidation as their loan is secured by the said movables. Incidentally, the question which automatically falls for consideration is whether such secured creditors can move

this court under Section 446(2)(b) of the Act and if not whether the applications are liable to be rejected as not maintainable.

4. The learned counsel appearing for the applicant companies have submitted their arguments at length. Shri Udaya Holla, the learned counsel in C. A. No. 617 of 1982, has placed reliance on a number of decisions to some of which reference will be made in the course of this order. Shri S. Vijayashankar, learned counsel appearing for the official liquidator, has strenuously opposed the prayers in the applications and has contended that the practice of this court has always been to dismiss claims by secured creditors who stand outside the winding up proceedings leaving them to work out their remedies in the appropriate civil court for enforcement of their security. He has specifically drawn my attention to the provisions of Section 47 in Part III of the Provincial Insolvency Act, 1920, which alone provides the mode and manner of settlement of the claims of a secured creditor by the official liquidator.

5. Both the applicants do not dispute that they have not enforced their security so far outside of making the applications under Section 446(2)(b) of the Act. Therefore, in effect, what is claimed now is right to possession of the hypothecated materials, possession in the sense of actual custody to which the applicants claim they are entitled by virtue of the terms contained in the deeds of hypothecation. It is only the alternative prayer in the first of the applications that speaks of payment of the amount realised by sale of the movables if custody is not given so that the sale proceeds will be adjusted against its dues.

6. It will be useful to deal with the alternative prayer in the first of the applications first and put it out of the way. In winding-up proceedings, no particular creditor, secured or otherwise, is entitled to payment on a preference, unless that be a statutory preference. The official liquidator is required to examine the claims of all the creditors, secured and unsecured, and settle the claims in accordance with law and the affidavits of proof filed before him in accordance with the law of insolvency. Those who stand outside the winding up proceedings are required to obtain decrees against the company in liquidation after making the official liquidator a party to such suits and enforce the decree against the official

liquidator. In other words, enforcement of security is to be done by procedure known to law and not by preferring claims under Section 446(2)(b) of the Act unless the secured creditor also stands within the winding up proceedings and takes his chance with others. Section 47 of the Insolvency Act clearly provides that the secured creditor may relinquish his security and stand in line with others and receive payment after valuing the security. This is very unlikely in most cases. The only situation when the secured creditor relinquishes his security and falls in line with the other creditors to receive the payment is when the company in liquidation is highly solvent and the security relinquished will not in any way affect the full payment of the amount secured. By doing so, a secured creditor will perhaps escape the rigour of a long-drawn out civil litigation in the enforcement of the security and then realise the debt. I, therefore, have no hesitation to come to the conclusion that on an application like this, it is impossible to grant the alternative prayer prayed for without knowing who are all the secured creditors and what is secured to them.

7. That only leaves the question of the maintainability of the applications under Section 446(2)(b) of the Act for possession. It is true that in the case of *Karnataka Light Metal Industries P. Ltd. v. Provisional Liquidator, Karnataka Steel and Wire Products Ltd.* [1985] 57 Comp Cas 668 (Kar), I did take the view that the true owner of a property may establish his claim to such property in an application under Section 446(2)(b) of the Act when that property has come into possession of the official liquidator by virtue of that property being situated on the site of the company in liquidation. Such claims can be visualised because even a stranger's car found in the factory premises of a company which has been ordered to be wound up may be seized by the liquidator and the real owner, therefore, has a right to move this court for return of what really is his property. That will not be the same in the case of a hypothecation where the creditor has a right to possession at his will, possession of the properties secured when the loan is not repaid or terms of the deed of hypothecation in other respects is violated by the borrower. Whether there is non-payment of loan, whether there has been violation of the other terms like reducing the value of security, frittering it away, etc., is a matter to be pleaded and proved before possession can be ordered, that too in an appropriate civil court. The company court normally would decline to entertain

such suits or claims and decide the questions involved in summary proceedings. It is in that circumstance that the present claim applications will have to be examined.

8. At one stage of the proceedings, the applicant in C.A. No. 617 of 1982 led evidence and marked hypothecation deeds in support of the claim. In the other application, no such step was required necessary as the question of maintainability had first come to be determined.

9. Following the decision of the Full Bench of the Delhi High Court, I have taken the view that an application filed under Section 446(2)(b) of the Act is not a suit. It is a species peculiar to the Companies Act which is distinct from a suit filed in a civil court. If this is borne in mind, then the question is readily answered, i.e., a security of movable or immovable property can be enforced only in accordance with the law applicable in that behalf and' in no other way. As against this, Mr. Udaya Holla relied upon the decision of this court in the case of Sree Yallamma Cotton, Woollen and Silk Mills Co. Ltd., In re, AIR 1969 Mys 280 ; [1970] 40 Comp Cas 466 (Mys), wherein it was held that the powers of the winding up court under Sub-section (2) of Section 446 include the jurisdiction to entertain and dispose of any question of priorities or any other question whatsoever, whether of law or of fact, which may relate to or arise in the course of winding up of a company, notwithstanding anything contained in any other law for the time being in force. That was no more than stating the actual language employed in Sub-clauses (b) and (d) of Sub-section (2) of Section 446 of the Act. That is not the same as stating that a bank like the applicant in the first of the petitions to which movables and machineries are hypothecated can seek possession of the hypothecated goods while standing outside the winding up proceedings. The court will assume jurisdiction to decide the priority only in relation to persons who are within the winding up proceedings. The security realised outside the winding up proceedings, therefore, must necessarily be settled in courts other than the company court. Any other view would lead to a situation that even a mortgage can be redeemed in a claim application as long as the mortgagor is a company in liquidation. That does not appear to be the general scheme of the Act. As earlier pointed out, as long as the provisions of the Provincial Insolvency Act are applicable to winding up

proceedings, then that law must prevail and there is no other way of the provisions of the Insolvency Act prevailing except to observe strictly the provisions contained in Section 47 thereof.

10. Similarly, Mr. Holla drew any attention to several decisions where the difference between goods hypothecated, pledged, etc., have been spelt out. It is true that in the case of pledge, the pledged goods can be sold by the pledgee when he has made the demand for its redemption and it has not been redeemed. If he performs that simple duty, then he has the right to sell with or without the intervention of the court. In the case of hypothecated machinery and movables, what is left with the secured creditor is the right to seek possession and not possession itself. Therefore, the question of possession does not arise when those hypothecated goods fall into the custody of the official liquidator by operation of law. Then the only remedy left open to the secured creditor is to realise the security by any other procedure known to law and definitely not by preferring a claim application under Section 446(2)(b) of the Act.

11. My attention was drawn to Section 28(6) of the Insolvency Act which declares in favour of a secured creditor his statutory rights notwithstanding what is contained in the preceding sub-sections. That is naturally so because the provisions made in Section 28 of the Insolvency Act is for the benefit of the creditor other than secured creditor. That will not in any way help the case of the applicants here who are outside the winding up proceedings and they are free as declared by that sub-section to enforce that security. The company court is not putting any restrictions on them at all. On the other hand, it is submitted by Mr. Holla that the bank has indeed filed a suit after this application was presented in this court by way of caution with the permission of this court and, therefore, that suit has been kept pending awaiting decision on the question of maintainability of this application, without progress. In other words, the applicant in the first of the applications has already chosen to enforce his security in a civil court and, therefore, he should not be permitted to maintain parallel proceedings even if I were to come to the conclusion that the applications are maintainable.

12. The fact that the prayer in the suit does not include sale of the hypothecated machinery and other movables and stock-in-trade will not be considered to entertain that prayer in this application as it is open to the plaintiff in the suit to seek an amendment of the prayer and bring to sale the goods in question for enforcement of the security.

13. It was lastly contended that the English courts in similar situation do entertain and issue summons on the chancery side as pointed out in Pennington's Company Law, 4th edition, at page 446. No doubt, the English practice appears to be to entertain summary proceedings in respect of all claims. But then the language of Section 231 of the English Act is in pari materia only to the extent of Section 446(2)(b) of the Act. It does not contain the provisions made in Clauses (b), (c) and (d) of Sub-section (2) of Section 446 of the Act. Whatever may be the practice in English courts, we must here follow that which is most convenient to our conditions. In the guise of settling a just claim, this court should not clutch at jurisdiction which may act as a precedent which later may result in rendering the company court into a civil court of summary jurisdiction. Therefore, the restraint to be imposed in such cases as this is more controlled by judicial restraint rather than by the construction of the provisions of law on their strict language.

14. For the above reasons, leaving it open to the applicants to realise their security in appropriate proceedings in civil court, their applications are rejected.

15. If in the meanwhile the official liquidator brings to sale any of these properties, the proceeds realised from such sale shall be kept intact until the applicants have obtained a decree for payment of such amount from the civil court or obtained any other restraint in respect of the goods hypothecated in accordance with law.

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