J.K. (Bombay) (P) Ltd vs New Kaiser-I-Hind Spg. & Wvg. Co. Ltd. & ... on 22 November, 1968

Equivalent citations: 1970 AIR 1041, 1970 SCR (3) 866, AIR 1970 SUPREME COURT 1041

Author: J.M. Shelat

Bench: J.M. Shelat, Vishishtha Bhargava, C.A. Vaidyialingam

PETITIONER:
J.K. (BOMBAY) (P) LTD.

Vs.

RESPONDENT:
NEW KAISER-I-HIND SPG. & WVG. CO. LTD. & ORS. ETC.

DATE OF JUDGMENT:
22/11/1968

BENCH:
SHELAT, J.M.
BENCH:
SHELAT, J.M.
BHARGAVA, VISHISHTHA
VAIDYIALINGAM, C.A.

CITATION:
1970 AIR 1041 1970 SCR (3) 866
CITATOR INFO :
R 1979 SC 734 (12,16)

ACT:
Companies Act 1 of 1956 Ss. 391, 392 & 433-Scheme under s. 391-Scope and nature of-Effect on right of creditors and other parties-On scheme becoming unenforceable if parties bound to operate it or Company to be wound up-Obligations undertaken by management to 'provide' finance for working company-If unlimited obligation or only one in commercial sense, i.e., with prospect of making profits.
Mortgage-Agreed to be executed under scheme in favour of unsecured creditors-Not executed at date of winding up-If amounted to charge in presenti in favour of the creditors.

HEADNOTE:

On a winding-up petition being filed in respect of the respondent company in June, 1965, a provisional liquidator was appointed, who took charge of the Cotton Textile Mills of the Company after they had stopped working. Thereafter an agreement was entered into in August, 1965 between the S group who owned the majority of equity shares in the company and the J group which agreed to buy the shares and to take over the management. The agreement provided, inter alia, that after the J group took over, the Company would execute a second legal mortgage of its fixed and other assets in favour of the S group and certain other unsecured creditors mentioned in Schedule B to the agreement m consideration of which those creditors; agreed to receive interest at a nominal rate and receive repayment of their debts over a long period. The agreement also contained provision which contemplated the Company obtaining loans from certain financial institutions, the Central and State Governments and other persons and securing them by a prior charge over its fixed assets as well as liquid assets;

After this agreement with the unsecured creditors and another with the workers union, the COmpany submitted a scheme for the sanction of the High Court. By an order in February, 1966, a single Judge of the High Court approved the scheme which provided, inter alia, for payments to various categories of creditors within specified periods and for the execution of a second mortgage in favour of the Schedule B creditors; or alternatively for the execution of a debenture trust deed 'and the issue of debentures in their favour if sanction of the Controller of Capital Issues could be obtained. It was also provided in clause (4) of the scheme that the J group "will provide the necessary finance required for running the mills". The winding-up petition was then withdrawn, the provisional liquidator discharged and 'the J group Wok over the Company's management. The mills were restarted in April, 1966 and payments to various categories of creditors other than the Schedule B creditors were duly made. However in view of certain disputes between the two groups, the company did not execute the mortgage or the proposed debenture trust deed in favour of the Schedule B creditors.

The mills continued to work until June, 1967, but the management experienced various difficulties in raising adequate working finances. in securing sufficient supplies of cotton, due to price rise following devaluation of the Rupee in 1966 and for various other reasons. In view of
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these the mills were eventually closed down in June, 1967, and thereafter the Company and others filed a petition for its winding-up. However, the Company Judge in the High Court took the view that under clause (4) of the scheme the J group were bound not only to procure but to personally bring in the finance sufficient to work the mills. Holding that the scheme was workable he directed the J group to

provide the necessary finance. He also directed the company to execute the debenture trust deed in favour of the unsecured creditors in Schedule B. He therefore dismissed the winding-up petitions. In appeal, a Division Bench of the High Court held that the Company Judge was in error in giving the said directions and in dismissing the petitions for winding-up. Accordingly, it allowed the appeals and ordered winding-up of the company.

In appeal to this Court it was contended inter alia that the Appeal Court was in error in setting aside the directions given by the Company Judge and in ordering winding-up instead; the Company had reached its unsatisfactory position in view of (i) the failure of the J group to provide finance in accordance. with clause (4) of the scheme; and (ii) giving away the processing unit of the mills which was the most profit yielding part of the mills for a nominal value to a nominee of the J group. It was also contended that once the scheme was sanctioned by the court, it became a statutory bargain and pan of the company's constitution, and therefore, all further arrangements of the company's affairs had to be on the basis of the rights and obligations thereunder; if the company were to be wound up, such winding-up could only be Ordered after compelling it to carry out those obligations and it would be opposed to equity and public policy to allow the company to escape its obligations by ordering it to be wound up; even if the scheme could be ignored by directing winding-up, it could only be done by putting the parties in the position they were prior to the scheme; and that the winding-up of the company being at the instance of the J group who had failed to carry out their obligation to find the finance, acceding to their prayer for winding up was tantamount to acceding to their default. It was further contended on behalf of the Schedule B creditors that the J group had deliberately failed to secure permission of the Controller of Capital Issues for execution of the debenture trust deed and that they were entitled to a charge on the company's assets not merely on the second mortgage being executed. but irrespective of it and in presenti; as the agreement of August, 1965, specified the property out of which a debt was to be payable and this was coupled with an intention to subject such property to a charge, the property became subject to a charge in presenti even though a regular mortgage was to be executed 'at some future date.

HELD: Dismissing the appeal:

(1) The direction of the Company Judge that the J group must provide the required finance was nebulous and vague and impossible of being enforced. In the.absence of any enquiry as to whether the mills could be worked at a profit no court would compel a party to furnish monies without even specifying how much 'and for how long he should provide. If such a direction was not possible, no direction could be given under s. 392(1)to work the scheme as its

implementation depended on the 'mills working at profit. The only course left to the Court was to pronounce that in the circumstances then prevailing the scheme could not be satisfactorily worked and, therefore, a winding-up order under s. 392(2) had become inevitable. [887 H---888 B]
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Although the scheme had statutory force, it had to be construed as a commercial document, that is, in the manner in which businessmen would read it. There can be no doubt that the J group took the responsibility to provide finance required for running the; mills so that from out of their profits the obligation to pay the creditors could be met in the manner laid down in the scheme. Therefore, the J group were to "provide" finance either on the credit of the company or on the security of its 'assets, or if necessary, their own monies for running the mills in the commercial sense, i.e. with a reasonable prospect of making profits and not in all events and in all circumstances. even if there was no prospect of running them in reasonable profit. Such a constitution would be contrary to the fact that the creditors knew there was hardly any chance of their being paid and wore anxious that instead of taking the company into liquidation the mills should be restarted and their dues paid bit by bit.

By virtue of the provisions of s. 391 of the Act, a scheme is statutorily binding even on creditors and share-holders who dissented from or were opposed to its being sanctioned. It has statutory force in that sense and therefore cannot be altered except with the sanction of the Court even if the share-holders and the creditors acquiesce in such alteration. The effect of the scheme is "to supply by recourse to the procedure thereby prescribed the absence of that individual 'agreement by every member of the clause. to be bound by the scheme which would otherwise be necessary to give it validity". Sub-sec. (2) of s. 391 of the Act allows the decision of the majority prescribed therein to bind the minority of creditors and shareholders and it is for that reason that a scheme is said to have statutory operation and cannot be varied by the shareholders or the creditors unless such variation is sanctioned by the court. The effect, therefore, of a scheme between a company and its creditors is that so long as it is carried out by the company by regular payment in terms of the scheme, a creditor who is bound by it cannot maintain a winding-up petition. But if the company commits a default, there is a debt presently due by the company and a petition for winding-up can be sustained at the instance of a creditor. The scheme, however, does not have the effect of creating a new debt; it simply makes the original debt payable and in the manner and to the extent provided in the scheme. It cannot be said that a winding-up order can Only be passed after compelling the company to complete the rights which are still incomplete under the scheme. [891 F]

Once a scheme is cancelled under s. 39'2(2) on the ground that it cannot be satisfactorily worked and a winding-up order passed, such order is deemed to be for all purposes one made under s. 433. It is not as if because the scheme has been sanctioned under s. 391 that a winding-up order under s. 39'2(2) cannot be made. If the contention, that a winding-up order can only be made subject to the rights and obligations of the parties under the scheme were to be right, it would mean that where a company makes default in paying an instalment on the date prescribed by the scheme and a creditor files a winding-up petition, even though a winding-up order is made on the basis that the debt has become presently payable, still the creditor is bound by the scheme and his debt is to be. payable by instalments as provided by the scheme. [893 C--E]

(2) The Appeal Court was right in holding that no proof had been offered in support of the allegation that the I group had let out the processing unit of the mills which was the most profit yielding part to one of their nominees to the prejudice of the company.

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(3) An examination of the scheme and the agreement of August 1965 did not show that there was any intention to subject the company assets a charge in presenti in favour of the Schedule B creditors. The provisions of these two documents amounted only to an agreement to mortgage which could give rise to an obligation to specifically perform it but did not constitute either a mortgage under s. 58 or a charge under s. 100 of the Transfer of Property Act. There was, therefore, no force in the contention that the: Schedule B creditors, irrespective of the proposed mortgage, were entitled to be treated as secured creditors. [889 G]

Jewan Lal Daga v. Nilmani Choudhuri, 55 I.A. 107; Khajeh Solehman Quadir v. Salimullah, 49 I.A. 153; Hukamchand v. Radha Kishan, A.I.R. 130 P.C. 76; referred to.

(4) On the findings by the Appeal Court that the company was commercially insolvent and the scheme could not be satisfactorily worked with or without modifications, the only alternative for that Court was to pass the winding-up order under s. 392(2). The. Court could not have completed, as contended by the appellants, their rights which were still incomplete or order the company to execute a debenture trust deed or the second mortgage, and thus set up the appellants and the other Schedule B creditors as secured creditors against the rest of the unsecured creditors. Such an order could not be passed as it would be contrary to and in breach of the right of distribution pari passu of the joint body of unsecured creditors. The Appeal Court had, therefore correctly followed the principle that the status of creditors which could be recognised was that which existed at the date of the' windingup order, that the second mortgage or the debenture trust deed not having so far been executed, the appellants and the other Schedule B creditors

were still unsecured creditors and therefore could not claim any priority over the rest of the unsecured creditors. [894 H---895 C]

Bank of Scotland v. Macleod [1914] A.C. 311 at 317, 318; Tulsidas Jasrai Parekh v. The Industrial Bank of Western India 32 Bombay Law Reporter 953 at 967; Re Anglo-Oriental Carpet Manufacturing Company [1903] 1 Ch. 914, referred to.

The principle that no act of a court should be permitted to harm a litigant who has acted on the faith of such an act cannot be invoked for the purpose of completion of rights where such' rights are incomplete at the date when a winding-up order is made. There was no question of the appellants having done something on the faith of an act of the court, the appellants and the other Schedule B creditors having agreed to a postponement of repayment to them in consideration of an agreement between them and the company providing for a second mortgage in their favour. [892 D]

Premila Devi v. Peaples Bank of Northern India Ltd., [1938] 4 All E.R. 337; Re Garner Motors Ltd., [1937] 1 All E.R. 671; Jang Singh v. Brijlal, [1964] 2 S.C.R. 145; Jai Behram v. Kedar Nath Marwari, 49 I.A. 351 at 356; Re Downing (T.H.) & Co. [1940] All E.R. 333; also Buckley on the Companies Acts (13th Ed.) 411 referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeals Nos. 1399 1402 of 1968.

Appeals from the judgment and decree dated April 26, 1968 of the Bombay High Court in Appeals Nos. 96, 97, 98 and 86 of 1967.

A.K. Sen, Krishna Sen, Rameshwar Nath and Mahinder Narain, for the appellant (in all the appeals). S.J. Sorabjee, 1. M. Chagla, K.D. Mehta, Ravinder Narain, J.B. Dadachanji and O.C. Mathur, for respondent No. 1 (in the appeals.).

F.S. Nariman and 1. N. Shroff, for respondents Nos. 2 and 3 (in C.A. No. 1399 of 1968).

B. Divan, Rameshwar Nath and Mahinder Narain, for Creditors Nos. 1 to 8 (in C.A. No. 1399 of 1968). C.K. Daphtary, Attorney-General, Rameshwar Nath and Mahinder Narain, for Creditors Nos. 9 and 10 (in C.A. No. 1399 of 1968).

The Judgment of the Court was delivered by Shelat,J. These appeals, rounded on a certificate, are directed against the order of the High Court of Bombay ordering the winding-up of Respondent No. 1 Company. Prior to August 1965, the company was managed by Singhanias, (referred to hereinafter as the J.K. group), who held 25,625 out of 45,000 equity shares of the company. By 1965 the company was in a bad way, its liabilities having exceeded its assets and was not in a position to pay its unsecured creditors. On June 21, 1965 one of its creditors, M/s. Indulal & Co., filed a petition for winding-up. On August 2, 1965 the Court appointed a provisional liquidator. On August 6, 1965 the cotton textile mills of the company stopped working and the provisional liquidator took charge thereof. On August 16, 1965 an agreement was made between the J.K. group and Nandial Jalan and two others, (hereinafter referred to as the Jalans), under which the latter agreed to take over the company's management on terms and conditions therein set out. The agreement provided that the J.K. group should sell to the Jalans at Rs. 10/- per share the said block of shares held by the former, that the J.K. group thereafter should resign as directors and accept as directors the nominees of the Jalans, that the company should execute a second legal mortgage of its fixed and other assets in favour of the J.K. group and certain other unsecured creditors named in Sch. 'B' to the agreement in consideration of which those creditors agreed not to claim interest at more than 1/4% and not to demand repayment of their debts except in the manner set out in the agreement and Sch. 'C' thereto, and that the transactions therein contained should be completed, within one month from the date when the said petition would be withdrawn. The agreement recorded that the debts due to Sch. 'B' creditors amounted to Rs. 48.28 lacs. Sch. 'C' to the agreement contained the terms to be included in the second mortgage to be executed by the company. Term 3 provid-

ed that the said Rs. 48.28 lacs were to be repaid two years after the date of the said mortgage by annual instalments of an amount equal to 50 per cent of the profit made by the company or Rs. 6.50 lacs whichever was lower, provided, however, that in any event the whole debt should be paid off by June 30, 1980. Term 4(a) provided that in the event of the assets secured under the second mortgage being damaged or impaired or the first mortgagees enforcing their security or the company being wound up, the entire debt due under the second mortgage would immediately become due. Term 4(d) contemplated the company obtaining loans from certain financial institutions including the Central and the State Governments and securing them by a prior charge over its fixed assets and therefore provided that in such an event "security of the second mortgagees for the fixed assets shall be subject to" such first or prior charge. Term 4(e) likewise permitted the company to Obtain loans from any person, firm or company on a first or prior charge over its liquid assets so that the security of the second mortgagees over the liquid assets "shall be subject to the first or prior charge in favour of such lender". There was already a first mortgage in favour of the Punjab National Bank Ltd. (hereinafter referred to as the 'Bank') for securing advances made by it to the company.

The effect of the said agreement was two fold: (1) that the Jalans by purchasing the said shares could take over the company's management, and (2) on the second mortgage being executed Sch. 'B' creditors, who, in respect of the debts due to them, were unsecured creditors, would take precedence over the other unsecured creditors by becoming secured creditors. No doubt, they agreed to accept 1/4% interest and to postpone the date of payment of their debts, nonetheless, in the event of the company being wound u13 the entire debt due to them would become immediately payable and they would have priority over the rest of the unsecured creditors.

On October 18, 1965 an agreement was made between the company, the Jalans and the workers' union, which inter alia provided that the new management would employ 2700 out of the total 4200 workers and pay to the rest retrenchment compensation.

Agreements with the largest group of unsecured creditors on the one hand and the workers on the other having been thus secured, the company took out on October 19, 1965 a summons submiting a scheme for the sanction of the High Court. It would seem that though the other creditors of the company were willing to accord their consent to the said scheme, the Bank was not, unless two cash credit accounts under which the company owed to it Rs. 19 lacs were paid off and a term loan of Rs. 26.75 lacs secured by a first mortgage of the company's fixed assets was reduced by Rs. 5 lacs. To remove the Bank's objection the Jalans had, therefore, to make an immediate financial arrangement. On February 14, 1966 an agreement between the company, (still under the old management), the Jalans and Sushil Investment (P) Ltd., a company under the control of the Jalans, was made whereunder Sushil Company agreed to pay off the said cash credits accounts and also to pay Rs. 5 lacs against the said term loan, in all Rs. 23 lacs. On so doing the Bank was to release the assets hypothecated with it and the company was to hypothecate such assets in favour of Sushil Company. Sushil Company also agreed to finance the company to the extent of Rs. 40 lacs including the said Rs. 23 lacs on the company hypothecating cotton cloth, yarn and other movable assets in its favour, and the Jalans giving their personal guarantee. This agreement under which the company agreed to hypothecate all its movable assets together with Term 4(d) and (e) of Sch. 'C' to the agreement of August 16, 1965 shows that it was understood between the parties that the Jalans were entitled to procure finance on the security of the company's assets, both fixed and movable, and that such security would take priority over the second mortgage to be executed in favour of the J.K. group and other S`h. 'B' creditors.

By his order dated February 17, 1966, Mody J., gave his sanction to the said scheme making therein two significant observations: (1) that all the concerned parties realised that the company at that stage was commercially insolvent, and (2) that though he appreciated the objection of some of the opposing creditors that the Jalans under the scheme gave no personal guarantee for payments provided thereunder to the unsecured creditors or for providing adequate finance for the working of the mills, he was giving his sanction as the majority of the unsecured creditors were anxious that the company should be allowed to work under the scheme. The preamble of the scheme expressly recites that it was "for the payment of the secured and unsecured creditors". Clause (1) sets out that the secured creditors were the Bank and M/s. R. Ratilal & Co., whose advances to the company were secured by hypothecation and mortgage in favour of the Bank and by a pledge of cotton in favour of R. Ratilal & Co. Clause (2) states that the unsecured debts of the company amounting to Rs. 101.39 lacs were due to four categories of creditors:

> Category k:consisted of
>
> (a) J.K. (Bombay) (P) Ltd. for Rs. 3.46 lacs, being the amount advanced by it to the company for purchase of 2000 shares of Bengal and Assam Investors. The company agreed to get these shares released from the Bank with which they were pledged and hand them over to this creditor within 90 days from the date of the order sanctioning the scheme.
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> (b) J.K. concerns and others to whom Rs. 48.39 lacs were due and who were mentioned in Sch. 'B' to. the agreement dated August 16, 1965. C1. (2) provided that

this amount was to be secured by a second mortgage of the company's assets in consideration whereof the creditors would accept payment in the manner provided by the agreement dated August 16, 1965, annexed as Ex. A to the scheme. Sub-clause (3) of cl. (2) provided that if the Controller of Capital Issues gave his sanction the second mortgage should be in the form of a debenture trust deed and the company should issue debentures of the said amount of Rs. 48.13 lacs of Rs. 100 each to these creditors ranking pari passu.

Category 2: Creditors were the Bombay Municipal Corporation, the Collector of Sales Tax, the Commissioner of Income Tax, the Bombay Port Trust, the Collector of Bombay, the Life Insurance Corporation, the Employees State Insurance Corporation, the workers, their cooperative society, and lastly the Tata Power Company Ltd. These were to be paid off within the time specified against their names.

Category 3: Creditors were 15 in number and were the suppliers of cotton and to whom Rs. 6.84 lacs were due. These were to be paid off in certain instalments, the first instalment being 37% of the debt, payable within 90 days from the date of sanctioning of the scheme.

Category 4: Creditors whose claims were Rs. 1000/- or less were to be paid off within 90 days after the sanction of the scheme. Creditors whose claims were above Rs. 1000/-, the total of whose debts amounted to Rs. 33.70 lacs, were to be paid off by 8 equal annual instalments, the first instalment being 121/2% payable within 90 days from the sanctioning of the scheme.

C1. (3) of the scheme referred to the said agreement dated October 18, 1965. Lastly, clause (4) provided that the Jalans "will provide the necessary finance required for running the mills". Except for cl. (4), the scheme thus represented an arrangement between the company and the creditors for repayment of debts due to the creditors. The Jalans were not parties to the scheme for at the date when it was sanctioned they were not either the shareholders or the directors though they appeared before Mody J., and gave their concurrence.

The scheme having been sanctioned, the winding-up petition was withdrawn, the provisional liquidator was discharged and all the assets taken charge of by him were handed over to the com-

pany. On February 22, 1966 the nominees of the Jalans were appointed directors and two days later the directors from the J.K. group, except Gopal Krishna Singhania, resigned. From and after that date the Jalans, according to the said agreement of August 16, 1965 took over the management of the company.

The scheme envisaged the restarting of the mills which had been closed from August 6, 1965, the repayment to categories H, III and IV of the unsecured creditors, in some cases in full and in the rest by instalments, the execution of the second mortgage by the company in favour of category 1(b) creditors or issuing of debentures in their favour to secure repayment of Rs. 48.13 lacs from out of the profits which may be made by the company by working the said mills and the handing over of the said investment shares to J.K. (Bombay) (P) Ltd. There can be no dispute that the scheme assumed that the mills would be worked and that from the profits which may accrue the J.K. concerns and other creditors of category (b) would be paid off by 1980 and in the meantime the debts due to them would be secured by a debenture trust deed or a second mortgage. This naturally meant that finance to work the mills had to be procured and that was why cl. (4) provided that the Jalans would provide the requisite finance.

There is reason to believe, and it so appears from the record also, that in the early stages at any rate, there was a genuine desire on the part of the Jalans to implement the scheme. In March 1966, the company's solicitors were instructed to prepare a draft debenture trust deed, which, after it was ready, was sent to the Singhanias for approval. Likewise, the mills were restarted on April 1, 1966, after spending, ,it was said, Rs. 5 lacs for setting the machinery into working order. May 17, 1966 was under the scheme the due date for payment in full to category II creditors and for payment of the first instalment to categories III and IV(a) and (b) creditors. It is undisputed that the company made these payments. What remained, therefore, to be implemented were the following: (i) the execution of second mortgage or the debenture trust deed, (ii) the transfer of the said investment shares and (iii) providing finance for working the mills.

Regarding the second mortgage, it appears that after the draft was sent for Singhanias' approval a dispute arose between the parties regarding interest payable on Rs. 48.13 lacs due to the Sch. 'B' creditors, the Singhanias claiming the original interest chargeable on advances made by them until the execution of the second mortgage and the Jalans replying that interest at 1/4% only was payable from August 16, 1965, the date of the agree-

ment between them and the J.K. group. Despite the controversy, the company applied on September 27, 1966 to the Controller of Capital Issues for sanctioning the ,debentures trust deed. It appears that along with the application the company had to send a treasury chalan for Rs. 50/-, that though a chalan was despatched it was under a wrong head, and, therefore, the Controller asked the company to replace it by a proper chalan. This the company did not do and the application remained unattended to. In the meantime, the Singhanias wrote to the company inquiring about the outcome of the company's application and requiring the company to send a copy of the application and the order made thereon. On coming to know that the sanction of the Controller could not be issued because of the technical defect in the chalan they sent Rs. 50/- to the Controller's office asking him to issue the sanction. That, of course, could not be done as the Singhanias had no locus stand in the matter of the said application since the application had to be made by the person desiring to issue debentures and sanction could be given to such applicant only. While this correspondence was going on, the Controller enquired of the company when the requisite chalan could be expected. The company thereupon requested him to keep the matter of sanction in abeyance. Mr. Sen contended that the Controller had already given his consent and that the only thing which remained to be done was to issue it to the company which could not be done by reason of the said defect in the chalan and that that being so, the company could have executed the debenture trust deed and issued the debentures. The correspondence on this subject, however, does not factually support the contention. The Controller did not proceed with the application as the company itself had written to keep the matter in abeyance. There is, however, no doubt that the company, if it had so desired, could have obtained the sanction and proceeded with the execution of the debenture trust deed. But it asked the

Controller to keep the matter in abeyance as the Jalans, rightly or wrongly, alleged that though Rs. 48.13 lacs were stated in the scheme to be due to the J.K. group, they were not entitled to that amount by reason of their having committed several fraudulent acts during the period of their management. We may mention that in the order made by the Company Judge in the summons for directions taken out later on by the Appellants he held that the affidavit of Goenka in which these allegations were made was not in conformity with Order XIX, rule 3 of the Code of Civil Procedure, and that therefore, they could not be taken notice of, that assuming that these allegations were true, the said alleged acts were of certain individuals, that the company's obligation was not affected thereby and that the proper remedy was to take proceedings against those individuals.

As regards the said investment shares, the company got those shares released and handed them over to J.K. (Bombay) (P) Ltd. but failed to hand over the transfer deeds therefore. There can, therefore, be no doubt that the company failed to implement this part of its obligation. As regards the implementation of cl. (4) of the scheme, the Jalans, as aforesaid, entered into an arrangement with Sushil Co., to which the J.K. Group were parties, under which Sushil Co. gave loans totalling Rs. 43 lacs including Rs. 23 lacs paid to the Bank. This arrangement was evidently made as moneys were immediately required to pay to the Bank, without which the Bank's objection to the scheme could not be removed and also because it would not presumably have been possible to have further dealings with the Bank. After the initial difficulties with the Bank were thus got over, fresh negotiations were started with the Bank and an arrangement was made whereunder the Bank agreed to advance Rs. 50 lacs provided the Central and the State Governments gave their guarantees therefore. Both the Governments were prepared to furnish their guarantees on a 50-50 basis for an advance of Rs. 50 lacs by the Bank against a pledge of stocks, stores etc. and a second charge on the company's fixed assets which charge under Term 4(b) of Sch. 'C' of the agreement of August 16, 1965 would have priority over the second mortgage in favour of Sch. 'B' creditors. The State Government even agreed to issue a provisional letter of intent pending completion of guarantee documents guaranteeing thereby 90 per cent of its share of Rs. 25 lacs, whereupon the Bank advanced Rs. 25 lacs, part of the intended loan of Rs. 50 lacs. With regard to the remaining Rs. 25 lacs, the Central Government was not prepared, as the State Government did, to give its guarantee until the documents were completed. On November 17, 1966 the Bank gave its consent to the company creating a second charge in favour of the two Governments on its fixed assets which were subject to a first mortgage in its favour. Though the Bank was agreeable to facilitate the said transaction, the J.K. group were not. By his letter dated July 7, 1966 Singhania contended that such a charge in favour of the two Governments which would have priority over the proposed second mortgage could only be in favour of financial institutions mentioned in the said Term 4(d) advancing the said loan and not the two Governments who were giving only their guarantee, and therefore, the company could grant to the said Governments only a third and not a second charge. Strictly speaking the company could give such a prior charge to the Bank and not to the two Governments. But the objection was technical and was raised for creating an obstacle in the way of the company getting the said advance from the Bank. It really made no difference to the creditors whether the prior charge was given in favour of the Bank or the two Governments. The result was that the Central Government declined to give its guarantee and the further advance of Rs. 25 lacs became unavailable. Even the provisional guarantee given by the State Government for a year in the first instance expired in July 1967.

The position which ultimately emerged was that the company got advances of Rs. 43 lacs from Sushil Co. of which Rs. 23 lacs were paid to the Bank. Rs. 20 lacs, however, remained with. the company presumably for meeting immediate payments under the scheme, the expenses needed to restart the mills and for other urgent purposes. The company obtained from the Bank an advance of Rs. 25 lacs on the provisional guarantee of the State Government and subsequently a further advance of Rs. 20 lacs on a further charge over its fixed assets. It was contended that though the company obtained Rs. 45 lacs from the Bank, none of it except Rs. 2 lacs remained with it for working the Mills as out of Rs. 45 lacs Rs. 43 lacs were paid to Sushil Co. against the loans given by that company. That, no doubt, is true, but as a result of these transactions Rs. 20 lacs out of Rs. 43 lacs advanced by Sushil Co. still remained with the company, Rs. 23 lacs only having been used to pay off the said cash credit accounts and in reducing the said term loan by Rs. 5 lacs. It appears from the record that at this stage the new directors had before them two alternatives:

> (1) to continue its liability to Sushil Co. in respect of Rs. 43 lacs or (2) to procure from the Bank a loan of Rs. 50 lacs on the guarantee of the two Governments. They obviously could not do both, continue the loan from Sushil Co. and to obtain the advances from the Bank as well, because the two Governments were prepared to furnish their guarantee only on the company hypothecating all its movable assets in their favour and giving a second charge on its fixed assets. Since the movable assets were already pledged with Sushil Co. unless they were released from that company and pledged with the two Governments, no guarantee would be forthcoming from them. Sushil Co., therefore, had to be paid off and the assets pledged with it released, unless of course that company was prepared to let go its right under the said agreement to have movable assets of the company hypothecated in its favour. In these circumstances it is difficult to say that the new management did anything palpably wrong in paying off Sushil Company particularly as there was every likelihood of the company obtaining Rs. 50 lacs from the Bank on the guarantee of the said two Governments. There is at the same time no doubt that no further finance was provided by the Jalans over and above these transactions.
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> The learned Company Judge took the view that under el. (4) of the scheme the jalans were bound not only to procure but to personally bring in the finance sufficient to work the mills, that by' paying off Sushil Co. and not bringing in further finance they starved the mills of finance and therefore could not be heard to say that the scheme had become unworkable. Holding that the scheme was workable he directed the Jalans to provide the necessary finance which meant that they must bring in their own finance in addition to any finance which they may or may not procure from elsewhere. He also directed the company to obtain sanction from the Controller of Capital Issues and to execute debenture trust deed within three weeks. In accordance with this view he dismissed the winding up petitions filed by the company and others. In the appeals against these orders the Appeal Court held that as Singhania himself had admitted in his affidavit that the company was commercially insolvent at the date when the scheme was approved and that the scheme could not be worked unless the Jalans provided the necessary finance there was nothing more to decide except as to

> whether the Jalans had undertaken an obligation to provide finance. The Appeal Court answered that ,question holding that "there was no binding obligation or duty undertaken by the Jalans to pay anything to the company or to compulsorily provide finance", that the company had become commercially insolvent, that no reasonable or prudent person would invest any of his moneys in the company, that its capital and reserves had been wiped out, that its substratum had disappeared inasmuch as its business of manufacturing cotton cloth could no longer be carried on with profit, and lastly, that therefore the scheme which was on the assumption that the mills could work and the company's debts would be paid from out of the profits could not be implemented. The Appeal Court was also of the view that the Company Judge was in error in giving the said directions and in dismissing the petitions for winding-up. Accordingly, it allowed the appeals and ordered winding-up. In doing so it rejected the contention that Sch. 'B' creditors had under the scheme already become secured creditors and had priority over the other unsecured creditors, or that in the alternative, the court should order winding-up only after directing the company to execute a second mortgage in their favour and thus implement the scheme which the company and the Jalans were bound to do. It also held that even assuming that the Jalans had brought about an impasse due to which the mills could not be run with any prospect of profits, their mala fides were not relevant once the court ,came to the conclusion that the company had become commercially insolvent.

Mr. Sen, as also the learned Attorney General, principally relied on two facts in support of their stand that the Appeal Court -was in error in setting aside the directions given by the Company Judge and in ordering instead winding-up of the company. These were (1) the failure of the Jalans to provide finance which would include their bringing in their own monies, and (2) giving away the processing unit of the mills which was the most profit yielding part of the mills for a nominal value to Jhunjhunwalas, the nominees of the Jalans. Mr. Sen commended the following propositions for our acceptance: (1) that the scheme when sanctioned by the court became a statutory bargain and part of the company's constitution, and therefore, all further arrangements of the pany's affairs had to be on the basis of the rights and obligations thereunder; (2) that if the company were to be wound up, such winding-up can only be ordered after compelling it to carry out those obligations and it would be opposed to equity and public policy to allow the company to escape its obligations by ordering it to be wound up, (3) that even if the scheme could be ignored by directing winding-up it could only be done by putting the parties in the position they were prior to the scheme, and (4) that the winding-up of the company being at the instance of the Jalans who had failed to carry out their obligation to find the finance, acceding to their prayer for winding-up was tantamount to acceding to their default. He firstly argued that no winding-up order should at all have been passed and the scheme ought to have been ordered to be implemented as the Company Judge did, and secondly, in the alternative, that even if the company were to be wound up, it should be so done subject to the implementation of the rights and obligations of the parties. The learned Attorney General adopted these contentions and in addition urged that Sch. 'B' creditors were entitled to a charge on the company's as. sets not merely on the said second mortgage being executed, but irrespective of it and in presenti under the scheme and the said agreement of August 16, 1965.

As regards financing the company, the contention was that under cl. (4) of the scheme the Jalans were bound to bring in their own monies required for working the mills and that they could not contend that because they could not procure. finance on the credit of or on the security of the assets of the company,. their obligation was over.' The Company Judge agreed with this view, but the Appeal Court, as aforesaid, took a different views held that under cl. (4) it was not as if the Jalans were bound' to provide finance in all circumstances or were bound to bring in their own monies. In our view both the Company Judge and the Appeal Court took, extreme views of cl. (4). It is clear from the sanctioning order of Mody, J., that the company at that stage was, and that fact was well-known to all concerned, commercially insolvent. A winding-up petition was at that stage pending before the High Court. There were, therefore, two alternatives before creditors, either to take the company in liquidation, Sup CI/69-5 in which event the creditors knew, as Mody, J., has observed, that they could not be paid their dues, or to restart the company under an arrangement whereunder it would work the mills and pay the debts gradually from out of the profits such debts in the meantime being secured by a second mortgage. The basis of the scheme, therefore, was that a new management would replace the old, the mills would be restarted and the unsecured creditors would be paid gradually from the profits. Every one including the Jalans must have realised that the mills could not be restarted and profits made unless necessary finance for working them was furnished. The scheme which was framed and sanctioned with their concurrence threw the responsibility of bringing finance on the Jalans.

It is true, as argued by Mr. Nariman, that the scheme was essentially an arrangement between the company. and its creditors and that the Jalans did not give any personal undertaking to the Court. Nevertheless, it was sanctioned by the court after the Jalans had concurred and given their assent through cl. (4) that they would provide the necessary finance. The word 'provide' in cl. (4) is of wide import which would mean that they would arrange for the finance, either on the credit of and security of the assets of the company or if necessary, by bringing in the monies themselves. In view of the language of cl. (4) we cannot agree with Mr. Nariman that the clause meant only finance secured on the assets of the company. At the same time even though the scheme is not a mere agreement but has statutory force it has to be construed as a commercial document, that is, in the manner in which businessmen would read it. There can be no doubt that the Jalans took the responsibility to provide finance required for running the mills so that from out of their profits the obligation to pay the creditors under cl. 2(ii) of the scheme could be met in the manner therein laid down. Therefore, the Jalans were to provide finance either on the credit of the company or on the security its assets, or if necessary, their own monies for running the mills in the commercial sense, i.e. with a reasonable prospect of making profits and not in all events and in all circumstances as the Company Judge appears to have thought, even if there was no prospect of running them at reasonable profit. Such a construction would be contrary to the fact that the creditors. including the workers and those who had supplied stores and other materials knew that there was hardly any chance of their being paid, and therefore, with few exceptions, were anxious that instead of taking the company into liquidation the mills should be restarted and their dues paid bit by bit. Thus, the assumption on which the scheme was made was that there was a possibility of running the mills successfully and that the creditors would be paid gradually out of the profits which the mills would make.

In the events that have happened it is impossible to say that the Jalans had no genuine desire to work the mills or that they did not; in the initial stages at any rate, make arrangements for financing the mills. This can be seen from the arrangement made with Sushil Co., their bringing the mills machinery in working order after the mills had remained closed for nearly 8 months and their arrangement with the Bank and the two Governments for a loan of Rs. 50 lacs. It is true, as pointed out by Mr. Sen that out of Rs. 45 lacs received from the Bank Rs. 43 lacs were utilised for paying off Sushil Co. leaving only Rs. 2 lacs therefrom as working capital. But, as already stated, they had to have the assets pledged with Sushil & Co. released in order to procure the guarantee of the two Governments on which alone the Bank was prepared to advance the new loan of Rs. 50 lacs. The two Governments on their part were prepared to stand a guarantee only if the company gave them a second charge on its fixed assets pledged and a hypothecation of all its movable assets. That could only be done by paying off Sushil & Co. and having the assets with it released. Whether what they did in these circumstances was right or wrong, the fact remains that had the deal with the Bank and the two Governments gone through, there would have been a further sum of Rs. 25 lacs over and above Rs. 20 lacs left from the loan by Sushil & Co. available as working capital. Besides restarting the mills, it is undisputed that the company, as provided by the scheme paid off the small creditors and also paid the first instalment due to creditors of categories Iii and IV(a) and (b). It is, therefore, impossible to say that the Jalans did not make efforts to work the mills or to implement the scheme. There is evidence on record, though the figures given by the Jalans are not admitted by the appellants, that though the working of the mills was at a loss it was continued upto June 1967.

But the contention was that the mills did not yield profits because of the Jalans having parted with the processing unit to Jhunjhunwalas. The allegation was that the company should have worked this unit as it was the most profit-yielding department, that Jhunjhunwalas were the nominees of Jalans, and that the rent or compensation, as the case may be, was a nominal one. The Company Judge directed termination of the agreement as he thought that if that unit had not been parted with at a nominal consideration it was possible to run the mills at profit and to implement the scheme. The Appeal Court rightly disagreed with the premises on which the said conclusion was arrived at. There could be no valid objection to the company entering into a lease or a licence agreement, for Singhania himself had in September 1965 asked permission from the Textile Commissioner to separate this unit and either to sell or lease it and the Textile Commissioner had assured him to consider the proposal favourably. The argument, nonetheless, was that in 1964-65 the company had earned Rs. 17.12 lacs from processing work of outsiders after processing its own goods, that after entering into the said agreement the company had in 1966-67 paid Rs. 21.77 lacs for processing its own goods and in the bargain got only Rs. 50,000 a month. On these figures it was urged that whereas the company earned a profit of Rs. 17 lacs in 1964- 65, it incurred a loss of a like amount in 196667 as a result of the aforesaid bargain. On these figures only the Company Judge directed the company to terminate the said agreement. The figures were, however, misleading because Rs. 17.12 lacs were the gross receipts and not net profit. Before arriving at net profits, cost of raw materials, labour, depreciation etc. had to be worked out and then only a true picture of the working of the unit would emerge. Besides, the,figure of Rs. 17 lacs does not take into account the cost of processing the company's goods and whether that had resulted in profit. This is important when it is remembered that the company paid Rs. 21 lacs in 1966- 67 for processing its goods though Jhunjhunwalas were to charge only cost price for processing the company's goods. It was, therefore, unsafe from a few figures to jump to the conclusion that had the unit not been parted with the mills would have made profit. It was said that the Jalans should have produced the company's accounts if they wanted to show that the terms on which they had parted with the said ,unit were profitable to the company. The Jalans gave several reasons why the account could not be produced. Whether they were true or not, even if the accounts had been produced they could not have thrown any light as no separate accounts were kept of the income and expenditure of the unit in 1964-65. But then if the unit was the most profit-yielding unit and had made large profit in 1964-65 one wonders why Singhanla should have applied for permission to sell or lease it. It is also difficult to believe that the Jalians would let out the unit at a nominal consideration only a month after they had restarted the mills as in the beginning at any rate they were genuinely interested in working the mills and implementing the scheme unless of course the allegation that Jhunjhunwalas were their nominees was true. But, as the Appeal Court has rightly said, no proof was offered in support of that allegation.

The next question is whether the closure of the mills was due to the Jalans having starved them of finance. Having perused the record and after hearing counsel we do not think such a conclusion possible. The correspondence between the Textile Commissioner, the Mills Federation and the company shows that from the middle of 1966 and onwards there was great difficulty in obtaining adequate quantity of cotton and particularly of the type required by the mills, that the supply position was worsening day by day and though the Government had fixed ceiling prices and a little later on enhanced them, dealers in cotton charged prices in excess of the ceiling prices. Even the Textile Commissioner had to acquiesce in the mills purchasing cotton at prices nearly 20% more than even the enhanced ceiling prices. Realising the difficulties in which its member/mills were placed, the Federation at first evolved a policy of voluntary restraint and advised its members not to purchase cotton in excess of their requirements for three months, to purchase only at ceiling prices and to close down the mills or reduce their spindleage if it was not possible for them to get cotton at ceiling prices. The Federation even agreed to reimburse the mills of lay off compensation if they were forced to close down for a while. Not only the prices of cotton but all other stores had spiraled up partly due to devaluation of the rupee on June 6, 1966 and partly due to the stock of cotton being less than the demand and Government's insistence to avoid unemployment that the mills should work at their full quota. As the position worsened after September 1966, 'the Federation revoked its earlier policy and permitted its members to buy cotton at prices above the ceiling prices as it was realised that on the one hand the mills were not getting cotton at prices fixed by the Government and on the other they were not permitted to restrict their spindleage. Prices of cotton of almost all varieties had by this time gone up by 50% above the ceiling prices. Realising the difficulty supply position Government on December 3, 1966 directed the mills to observe one extra holiday per week and to pay lay-off compensation for such extra holiday. On December 7, 1966 the company wrote to the Textile Commissioner that as it was not getting the requisite type of cotton it had reduced its count from 30 to 20, that till that day it had not received a single requisitioned bale, that though the dealers were directed to sell cotton at Rs. 1430 a bale they were charging Rs. 1600 a bale and that lay-off compensation for the extra holiday imposed by Government meant an additional burden of Rs. 80,000 a month. On December 12,- 1966 the company demanded of the Textile Commissioner to requisition cotton required by it. No cotton was delivered to the company although the Textile Commissioner promised to requisition it. On December 23, 1966 the Essential Commodities Ordinance, 13 of 1966 was promulgated empowering the Government to direct an employer not to close his establishment without the authorised officer's permission, not to work the establishment for more than the prescribed days and hours and to pay lay-off compensation where the employer obtained permission for closure. The next day Government issued an order directing that no employer should close wholly or partially his undertaking without the permission of the Textile Commissioner and directed all establishments to observe an extra holiday per week and to pay lay-off compensation for it. On December 25, 1966 Government informed the company that no permission would be given to any mill for not giving the extra holiday. In view of there being no possibility of getting proper cotton the company asked for a quota of terylene fibre as a substitute. That also could not be procured. Meanwhile, the company had deposited with the Federation Rs. 12,500 as advance towards the price of cotton which may be requisitioned for it. In February 1967, some cotton was requisitioned for the company but the sellers could not deliver it as the authorities had sealed their godowns and prohibited removal of cotton therefrom. On February 15, 1967 the company put up a notice of closure owing to want of cotton. A few days later it requested the Textile Commissioner for requisitioning 2000 bales stating that the company was not in a position to buy cotton at excess prices. The reply was that 150 bales were requisitioned for it, that the question of requisitioning 350 bales more was under

> consideration but that the company should appreciate that it cannot go on requisitioned cotton only. The implication was that the company must manage to buy cotton even at exorbitant prices. So far out of 2000 bales demanded only 200 bales had been allotted to the company. Even in respect of these bales the sellers would not permit their sample survey to ascertain their quality. In March 1967, the spinning department was partially closed causing labour unrest. The cotton position in April 1967, as explained by the company in its letter of April 25, 1967 was as follows: 1282 bales were allotted to the company between February 15, 1967 and April 20, 1967 out of which the company took delivery of 200 bales. No survey by sample was allowed in respect of 732 bales. Survey made by the suppliers of 350 bales was challenged by the company. In respect of the balance of 250 bales the company disputed the right of the suppliers to demand clearance charges and that dispute was referred to the Textile Commissioner. From this letter alone and without reading it in the context of the previous correspondence, the Company Judge concluded that though cotton was requisitioned for it the company had declined to lift it. The conclusion was neither fair nor just. It stands to reason that no purchaser would take delivery of goods unless he is satisfied from their survey that they were of the quality for which he had paid. If the suppliers declined to permit survey the company could not be accused of refusing delivery. Mr. Sen argued that the company could not depend upon getting cotton at ceiling prices or on cotton requisitioned for it and that it should have purchased it even at excess prices just as other mills were doing. If that contention was right there was no point in Government fixing the ceiling prices. It may be that other mills might have purchased cotton at excess prices, but if the finances of the company did not permit that luxury it is difficult to hold that the company was guilty of any dereliction. Even apart from having to pay high prices for cotton, the mills had to pay Rs. 80,000 a month because of the compulsory extra holiday.

In the meantime several other difficulties were mounting up. The affidavit of Goenka shows that the mills were working at a loss of Rs. 1.5 lacs a month and the total losses by June 1967 had risen to Rs. 28 lacs. These figures were not admitted by the appellants as the company did not produce books of accounts. The' precision of the loss could be disputed but not the fact. On May 9, 1967 the guarantee given by the State Government for one year expired and a fresh arrangement with the Bank became necessary. The Government would not renew its guarantee as Singhanias had objected to a second charge being made in its favour. On May 17, 1967 the second instalment payable under the scheme to categories III and IV(b) creditors amounting to over Rs. 5 lacs became due. The mills were for the reasons stated above closed on June 4, 1967 with the consequence that the company became liable to pay to 2700 workers retrenchment compensation. By the time the winding-up petitions were heard the company had already become liable to pay a large amount by way of retrenchment compensation. The closure of the mills was followed by workers' unrest culminating in hunger strikes and prevention of the directors from entering the mills and disposal by them of cotton, cloth and other articles. If the scheme were to be worked as directed by the Company Judge it meant paying of the retrenchment compensation, putting the machinery once again in working order etc., requiting large amounts to meet these claims and expenses.

The argument, however, was that the Jalans were to thank themselves for this calamity. But, surely, they could not be blamed, however badly they might have behaved in other respects, for the closure of the mills which was due to reasons beyond their control, viz., the price rise due to devaluation which overtook them only two months after they restarted the mills, the impossibility of getting cotton at reasonable prices, and the imposition of the extra holiday which meant both loss of production and the burden of lay- off compensation. It is, therefore, not fair to say that the Jalans were responsible for the closure of the mills either on the ground of failure to lift the cotton or by their having given away the processing unit as alleged. As regards cl. (4) of the scheme, we do not agree with the learned Attorney General that the jalans had to finance the mills from their own monies only nor with Mr. Nariman that their obligation was confined only to arranging finance on security of the company's assets. Both of them took up extreme positions with which it is not possible to agree. On the one hand sub-cls. (d) and

(e) of Term (4) of the said Sch. 'C' clearly contemplate the right, of the Jalans to arrange finance on the security of the company's' assets. On the other hand it must have been clear to them that as the company's assets were already mortgaged and pledged, further finance would have to be brought in either by them or on their own credit. In cases such as the one before us, the scheme has to be read as a commercial document, that is, in the sense in which businessmen conducting such an establishment would understand. If so read, cl. 4 cannot mean that the Jalans had taken upon themselves the liability to put in monies even if the mills could not be run at reasonable profits.

No industrial establishment is ordinarily run except in the hope of doing so at profit. Considering the circumstances which existed in 1966-67 we cannot say that the conclusion of the Appeal Court that there was no reasonable prospect to run the mills at profit was incorrect.

The company was commercially insolvent when the scheme was sanctioned. It was concurred in by the Jalans in expectation that the company could be resuscitated and the mills worked at reasonable profit. By June 1967, when the mills were closed and the company filed the winding-up petition, it was commercially insolvent in the sense that its assets and its existing liabilities were such as to make it reasonably certain that the existing and probable assets of the company would be insufficient to meet its liabilities. Besides, the very object for which the company was formed, namely, to run the mills commercially, had failed. By November 6, 1967 when the Company Judge delivered his judgment, apart from the company's debts being in excess of its assets, the company's total losses and its liability to pay retrenchment compensation to its workers had run into considerable figures. Although the figure of Rs. 28 lacs for such losses and Rs. 5 lacs a month for compensation were not admitted by the appellants, there can be no doubt that the company had been running the mills at loss and its liability for retrenchment had swelled to a large figure.

Under sec. 392 of the Act the High Court which has sanctioned the scheme has the power to supervise the carrying out of it and to give directions in regard to any matter or to make modifications in it as it may consider necessary for its proper working. But if the Court is satisfied that the scheme cannot be worked satisfactorily with or without modifications, it can either suo moto or on an application by any person interested in the company's affairs order its winding-up. Both Mr. Sen and the learned Attorney General contended that the Company Judge was right in holding that the scheme could have been worked but for the defaults of Jalans, that the Company Judge was right in giving directions under sec. 392(1) compelling the Jalans and the company to implement their obligations and that no winding-up order in exercise of power under sec. 392(2) should have been passed. We have examined the circumstances in which and the reasons why the company closed the mills and held that theft closure was for reasons beyond the control of the company. As Mody, J., had, while sanctioning the scheme, observed, he sanctioned it only because most of the creditors, except a few, were anxious that instead of the company being wound up, it should be given an opportunity under a new management to work so that, it may pay off gradually the debts due to them by working its millS. The assumption, therefore, on which the scheme was framed was that the company could work the mills profitably and pay off its creditors from out of the profits. Therefore, it was not as if the mills had to be worked even if their working resulted in loss. Assuming that the Jalans were under an obligation to bring in finance including their own monies, they could not be said to be under an obligation to bring in finance even if the working of the mills showed no reasonable prospect of profit. If the mills could not be worked except at loss the company would be justified in ceasing to work them. The very object of the company being to manufacture cloth, if the mills had to be closed that would mean that the very object for which the company existed and which also was the assumption on which the scheme was flamed ceased to exist.

The direction of the Company Judge that the Jalans should bring in the necessary finance could only be on the basis that the mills could be successfully' worked. But before giving such a direction he did not, and indeed could not, on affidavits only, ascertain whether in the circumstances then existing there was any reasonable prospect of profits. If there was not, it stands to reason that the court could not compel the Jalans to work the mills at loss and equally could not compel them to pour in their monies in such an undertaking. Besides, the direction did not, and in the very nature of things, could not, specify how much finance the Jalans were to bring in. If the Jalans were to bring in the finance, assuming there was a binding obligation on them to do so, they would do so in the expectation that they would be repaid. The words "necessary finance required for running the mills" in cl. 4 of the scheme must necessarily mean the amount which a reasonable and prudent financier would think necessary for working the mills at profit and not an unlimited amount in a concern which cannot be expected to work at reasonable profit. The direction did not also specify on what terms the Jalans should bring in their monies nor the terms upon which they would be repaid. It was, therefore, nebulous and vague and impossible of being enforced. In the absence of any enquiry as to whether the mills could be worked at profit no court would compel a party to furnish monies without even specifying how much and for how long he should provide. If such a direction was not possible, no direction could also be given under sec. 392(1) to work the scheme as its implementation depended on the mills working at profit. The only course left to the Court was, as the Appeal Court did, to pronounce that in the circumstances then prevailing the scheme could not be satisfactorily worked and therefore a winding-up order under sec. 392(2) had become inevitable. By the time the Appeal Court passed its order, the mills having been closed since June 1967, a huge amount had become payable as retrenchment compensation.

But it was urged that assuming that a winding-up order in these circumstances could be passed it had to be subject to the rights and obligations of the parties. The contention was that irrespective of the second mortgage which the company had to execute, Sch. 'B' creditors had already become entitled to a charge on the company's assets. It was argued that where an agreement specifies 'a property out of which a debt is to be payable and is coupled with an intention to subject such property to a charge, the property becomes subject to a charge in presenti even though a regular mortgage is to be executed at some future date. Such an intention, the learned Attorney General argued, was demonstrated by the agreement that (1) the debts were to be paid out of profits and (2)'the engagement by the company not to deal with its assets. The distinction between a charge and a mortgage is clear. While in the case of a charge there is no transfer of' property or any interest therein, but only the creation of a right of payment out of the specified property, a mortgage effectuates transfer of property or an interest therein. No particular form of words is necessary to create a charge and all that is necessary is that there must be a clear intention to make a property security for payment of money in presenti. In Jewan Lal Daga v. Nilmani Choudhuri,(1) a case relied on by him, the question was one relating to an agreement to mortgage. Following on the agreement,_ a draft mortgage was prepared which was. approved by the respondent's solicitors, the mortgage deed was engrossed and even the stamp for it was paid by the respondent. The question was whether specific performance of the agreement completing the respondent to execute the mortgage could be granted before accounts between the parties were made up and the amount due thereunder was ascertained. The Privy Council disagreeing with the High Court held that that could be done and observed that "there was a valid agreement charging the property with whatever sum was actually due .... and that a proper mortgage ought be executed to carry out these terms." In Khajeh Solehman, (1) 55 I.A. 107.

Quadir v. Salimullah (1) certain deeds were executed purporting to make wakfs of certain properties in favour of the members of a Mahomedan family and then for charitable purposes. Later on, agreements were executed, under one of which the members. of the family agreed that allowances fixed under the wakfs should be paid out of the income to named persons of the family and upon their death to theft heirs, and under the other agreement the mutawalli agreed that he and the future mutawallis would pay the said allowances. The wakfs were held invalid as creating a perpetual succession of estates. The question was whether the agreements to pay allowances also fell along with them. The' Privy Council held that they did not, that they Were valid and enforceable and that the direction in the agreements to pay the allowances out of the income of the settled properties showed an intention to create a charge. In both these decisions the Board came to the conclusion that there was a clear intention on the part of the parties to create a charge in presenti. The argument of the learned Attorney General was that if an agreement indicated a property out of which a debt is to be paid and an intention to subject it to a charge in presenti, the court must find the charge. Certain other decisions were also brought to our notice but it is not necessary to burden this judgment with them because in each case the question which the court would have to decide would be whether' the agreement in question creates a charge in presenti.

C1. 2(ii) of the scheme first sets out Rs. 48.13 lacs as being due to Sch. 'B' creditors and then provides that the said amount would be repaid by annual instalments of an amount equal to 50% of the profits which the company would make, such instalments commencing after two years from the date of the execution of the second mortgage. C1. 3 of the agreement of August 16, 1965 provides for the execution of the second mortgage in consideration of the said creditors agreeing to accept repayment in accordance with the terms in Sch. 'C' thereto. Term 3 in Sch. 'C' provides the said mode of repayment and term 4 provides that in the events there set out the debt or the balance thereof remaining unpaid would become immediately payable. In our view, neither the scheme nor the said agreement shows any intention to subject to the company's assets to a charge in presenti. All that they provide is a promise to create a second mortgage which was. to contain the terms set out in the said Sch. 'C' in consideration for which the creditors 'agreed to postpone repayment in the manner therein provided. Thus the scheme merely contains an agreement to mortgage and the mode of repayment and the said agreement provides for (a) the sale of shares and (b) a promise to postpone repayment in consideration of a second mortgage to (1) 49 I.A. 153.

be executed by the company. Even if term 4 in the said agreement can be construed to mean an engagement not to deal with the assets of the company, that by itself, in the absence of an intention to create a charge under the agreement, would not be enough to hold that it creates a charge. [cf. Mulla's Transfer of Property Act, (5th Ed.)

616.] In our view the said provisions of the scheme and the agreement amount only to an agreement to mortgage which can give rise to an obligation to specifically perform it, a personal obligation, but do not constitute either a mortgage under sec. 58 or a charge under s. 100 of the Transfer Property Act. (cf. Hukumchand v. Radha Kishan)(1). The claim urged on behalf of Sch. 'B' creditors that they had a charge irrespective of the proposed mortgage and were entitled to be treated as secured creditors cannot therefore be upheld.

The contention next was that a scheme sanctioned by the court being binding on the company, its shareholders and the creditors, anything done contrary to its provisions is ultra vires the company. Therefore, if the company is wound up it could be so done subject to the rights and obligations under such a scheme. The order of the Appeal Court was, therefore, wrong inasmuch as it could pass a winding-up order only after the company had been made to perform its obligations under the scheme, that is, after it had been made to execute the debenture trust deed or the second mortgage. Reliance in this connection was placed upon the decision in Premila Devi v. Peoples Bank of Northern India Ltd.(2) where the respondent bank had issued A & B shares of which Rs. 50/- on each such share out of the face value of Rs. 100 were called up. The bank being in difficulty, a scheme was prepared which was sanctioned by the court. Later on the scheme was mended and that also was sanctioned by the court. 'The scheme so amended provided that further calls on A & B ,shares should not exceed 25% which included 20% already called by the directors between the passing of the original and the amended scheme and provided further that the balance of 5% call should be payable in 5 instalments payable each half year. The directors, however, resolved that the said 5% should be paid on February 26, 1933 ignoring the amended scheme and later passed another resolution forfeiting the shares of those who failed to pay by the aforesaid date. The bank thereafter went into liquidation and the liquidator contended that the forfeitures were ultra vires the bank being contrary to the scheme and that the names of those shareholders should be included in the fist of contributories. The Privy Council held (1) that the amended scheme once sanctioned by the court became binding on the company, the creditors and the shareholders and its terms could be (1) A.I.R. 1930 P.C. 76. (2) [1938] 4 All E.R.

337. varied only by an order of the court after such variation was approved at meetings of the creditors and the shareholders; (2) that, therefore, it was not possible for the bank or the directors or the shareholders, whether by resolution or ratification or otherwise, to alter the dates of payments of the call monies fixed by the scheme; (3) that the resolution calling the call money on a date different from those dates was ultra vires the company and the forfeitures in pursuance of the said resolution, even if ratified by the shareholders, were equally ultra vires, and that the liquidator therefore was entitled to include the names of those shareholders in the list of contributories. It is difficult to say how this decision can assist the appellants for neither the company nor the directors have passed any resolution over-riding the provisions of the scheme while it was in operation. The problem is whether in relation to the incomplete rights of the appellants the Appeal Court was bound first to call upon the company to complete those rights and then pass a winding-up order. The decision in Premila Devi's case(1) had nothing to do with the winding-up of the company or the correctness of an order of windingup and is, therefore, not relevant to the question before us. The case of Re Garner. Motors Ltd.,(a) relied on by Mr. Sen lays down that though a joint debtor would ordinarily under the principle of accord and satisfaction be released from his liability if the debt is paid up by the other joint debtor, a release of one of them under a scheme of arrangement is a release by operation of law and not under accord and satisfaction and therefore would not relieve the other joint debtor. The principle is that a scheme sanctioned by the court does not operate as a mere agreement between the parties: it becomes binding on the company, the creditors and the shareholders and has statutory force, and therefore, the joint-debtor could not invoke the principle of accord and satisfaction. By virtue of the provisions of sec. 391 of the Act, a scheme is statutorily binding even on creditors ,and shareholders who dissented from or opposed to its being sanctioned.

It has statutory force in that sense and therefore cannot be altered except with the sanction of the Court even if the shareholders and the creditors acquiesce in such alteration of Premila Devi v. Peoples Bank(1). The effect of the scheme is "to supply by recourse to the procedure thereby prescribed the absence of that individual agreement by every member of the class to be bound by the scheme which would otherwise be necessary to give it validity". (Palmer's Company Law, 20th Ed. 664) Sub-sec. (2) of sec. 391 of the Act allows the decision of the majority prescribed therein to bind the minority of creditors and shareholders and it is for that reason that a scheme is said to have statutory operation and cannot be varied by the share-

(1) [1938] 4 All E.R. 337. (2) [1937] 1 A11 E.R. 671.

holders or the creditors unless such variation is sanctioned by the ,court. The effect, therefore, of a scheme between a company and its creditors is that so long as it is carried out by the company by regular payment in terms of the scheme a creditor who is bound by it cannot maintain a winding-up. petition. But if the company Commits a default, there is a debt presently due by the ,company and a petition for winding-up can be sustained at the instance of a creditor. The scheme, however, does not have the effect of creating a new debt; it simply makes the original debt payable in the manner and to the extent provided in the scheme. The proposition that a winding-up order can only be passed after compelling the company to complete the rights which are still incomplete is not borne out by the decisions relied on by Mr. Sen.

Reliance was also placed on the principle that no act of a court, (in the present case' the sanctioning of the scheme) should be permitted to harm a litigant who has acted on the faith of such an act and that such a person should be restored to the position he would have occupied but for that act. (cf. Jang Singh v. Brijlal(1) and Jai Behram v. Kedar Nath Marwari(2). We do not see how this principle can be invoked for the purpose of completion of rights where such rights are incomplete at the date when a winding-up order is made. There is no question of the appellants having done something on the faith of an act of the court, the appellants and the other Sch. 'B' creditors having agreed to a postponement of repayment to them in consideration of an agreement between them and the company providing for a,second mortgage in their favour.

Next, it was said. that by reason of sub-section 3 and 4 of sec. 391 a scheme once sanctioned becomes part of the company's constitution. Therefore, the company cannot be ordered to be wound-up except in conformity with the rights and obligations of the parties under such a scheme. But sub-sec. 3 only provides that an order sanctioning a scheme begins to operate only when a certified copy of such order is filed with the Registrar. Thus, the sub-section merely lays down a condition precedent to the coming in force of a scheme and does not deal with rights and obligations of parties under such a scheme. Sub-sec. 4 requires a copy of such order to be annexed to every copy of the memorandum of the company issued after the certified copy of the order has been filed with the Registrar, and sub-sec. (5) provides penalty for default of this requirement. These sub-sections were presumably introduced to ensure notice of the order sanctioning the scheme to persons dealing with the company so that they may deal with the company henceforth with the knowledge of the (1) [1964] 2 S.C.R. 145. (2) 49 I.A. 351 at

356. scheme. But the sub-sections do not mean that the scheme becomes part of the constitution of the company. Sub-sec. (4) clearly lays down that a copy of the order is to be annexed to a copy of the memorandum issued after its certified copy has been filed with the Registrar, that is, after the operation of the scheme commences. A scheme, therefore, is not to be considered for instance, as modifying existing special rights attached to shares unless such modification is provided for in the scheme. [cf. Re Downing (T.H.) & Co.(1)]. The contention, therefore, that the scheme becomes part of the company's constitution or of its memorandum, and therefore, a winding-up order cannot be passed except in conformity with the altered constitution of the company, is not tenable. So long as the scheme is in operation and is binding on the company and its creditors, the rights and obligations of those on whom it is binding are undoubtedly governed by its provisions. But once the scheme is cancelled under sec. 392(2) on the ground that it cannot be satisfactorily worked and a winding-up order passed, such an order is deemed to be for all purposes to be one made under sec. 433. It is not as if because the scheme has been sanctioned under sec. 391 that a windingup order under sec. 392(2) cannot be made. If the appellants' contention, that a winding-up order can only be made subject to the rights and obligations of the parties under the scheme were to be right, it would mean that where a company makes default in paying an instalment on the date prescribed by the scheme and a creditor files a winding-up petition, even though a windingup order is made on the basis that the debt has become presently payable, still the creditor is bound by the scheme and his debt is to be payable by instalments as provided by the scheme.

The effect of a winding-up order is that except for certain preferential payments provided in the Act the property of the company is to be applied in satisfaction of its liabilities pari passu. Pari passu distribution is to be made in satisfaction of the liabilities as they exist at the commencement of the winding-up. (of. secs. 528 & 529 of the Act; Ghosh on Indian Companies Law, 11th Ed. Vol. 2, p. 1073), The effect of a winding-up order on rights already completed as against rights yet to be completed is succinctly stated by Lord Halsbury in the Bank of Scotland v. Macleod(2) as follows:

> "Rights in security which have been effectually completed before the liquidation must still receive the effect. which the law gives to them. But the company and its liquidators are just as completely disabled by the winding-up from granting new or completing imperfect (1) [1940] All E.R. 333; also Buckley on the Companies Acts (13th Ed.) 411. (2) [1914] A.C. 311 at 317, 318.

rights in security as the individual bankrupt is by his bankruptcy. This, indeed, is the necessary effect of the express provisions of the Companies Act that the estate is to be distributed among the creditors pari passu. Every creditor is to have an equal share, unless' any one has already a part of the estate in his hands, by virtue of an effectual legal right."

[cf. Tulsidas Jasraj Parekh v. The Industrial Bank of Western India(1)]. Similarly, in Re Anglo-Oriental Carpet Manufacturing Company(2) it was held that even where a company had executed a trust deed and issued debentures creating a charge on its assets but the charge had not been registered as required by the Companies Act by the time the company had passed an extraordinary resolution for voluntary winding-up the debenture holders were not, as against the joint body of creditors, secured creditors. It is thus well established that once a winding-up order is passed the undertaking and the assets of the company pass under the control of the liquidator whose statutory duty is to realise them and to pay from out of the sale-proceeds its creditors. Such creditors acquire on such order being passed the right to have the assets realised and distributed among them pari passu. No new rights can thereafter be created and no uncompleted rights can be completed, for doing so would be contrary to the creditors' right to have the proceeds of the assets distributed among them pari passu. But Mr. Sen's argument was that the appellants had acquired under the scheme a vested right to have a second mortgage which 'could not be nullified by the court passing the windingup order. We cannot accede to this contention for the scheme vested no such right. What it did provide was that in consideration of the company agreeing to execute a second mortgage the appellants and the other Sch. 'B' creditors agreed to receive repayment of debts due to them in the manner provided in the scheme and the agreement of August 16, 1965. On failure of the company to execute the mortgage the consideration for postponement of repayment failed and the monies due to those creditors became immediately payable. It is also not correct to say that the scheme gave any priority to those creditors. Such a priority could result only on the execution of the mortgage which would make them secured creditors.

On the findings by the Appeal Court that the company was commercially insolvent and that the scheme could not satisfactorily be worked with or without modifications, the only alter-

(1) 32 Bombay Law Reporter 953 at 967. (2) [1903] 1 Ch. 914.

native for that Court was to pass the winding-up order under sec. 392(2). The Court could not have completed, as contended by the appellants, their rights which were still incomplete or order the company to execute a debenture trust deed or the second mortgage, and thus set up the appellants and the other Sch. 'B' creditors as secured creditors against the rest of the unsecured creditors. Such an order could not be passed as it would be contrary to and in breach of the right of distribution pari passu of the joint body of unsecured creditors. The Appeal Court, therefore, correctly followed the principle that the status of creditors which could be recognised was that which existed at the date of the winding-up order, that the second mortgage or the debenture trust deed not having so far been executed, the appellants and the other Sch. 'B' creditors were still unsecured creditors and therefore could not claim any priority over the rest of the unsecured creditors. In the result, we are of the view that the Appeal Court was right in ordering winding-up of the company and we uphold that, order. Appeals are dismissed with costs. As there has been one common argument, we think it proper that there should be one set of costs for all the respondents in these appeals. The creditors for whom the learned Attorney General and Mr. A.B. Divan appeared will bear their own costs.

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R.K.P.S.                                  Appeals dismissed.
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