Syndicate Bank vs West Bengal Cements Lts. And Others on 10 October, 1988

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Bench: Y.K. Sabharwal

ORDER

Y.K. Sabharwal, J.

1. The plaintiff, Syndicate Bank, has filed this suit for recovery of Rs. 33,39,026.75. The case as set up in the plaint is that the bank, amongst various other facilities,sanctioned an overdraft limit of Rs. 10,00,000 to defendant No. 1 company against hypothecation of fiat cars, jeeps and commercial vehicles. The defendants, in consideration of the said overdraft limit, executed a demand promissory note dated February 2, 1972, for the said sum of Rs. 10,00,000 carrying interest at 10.5% per annum for the time being. The defendants also executed further documents as set out in the plaint and availed of the said overdraft limit of Rs.10,00,000. The defendants acknowledged their liabilities in writing to the extent of Rs. 11,83,327.95 as on December 31, 1974, by acknowledgement of debt dated January 31, 1975. It is further claimed that in spite of acknowledgment pf liability, the defendants failed to deposit money in the said overdraft account and when called upon to deposit the sale proceeds of the hypothecated vehicles, the defendants stated that the same had been utilised elsewhere and they were not in a position to pay the same to the bank. By resolution dated January 7, 1977, the defendants again acknowledged their liabilities in respect of the said overdraft account. Once again by resolution dated January 14, 1977, the defendants acknowledged their liabilities in respect of the said overdraft account and also confirmed the previous acknowledgment dated January 31, 1975. By acknowledgment of debt dated November 16, 1977, the defendants admitted their liabilities to the extent of Rs. 17,38,401.85 as on December 31, 1976, with interest thereon from January 1, 1977, under the promissory note dated February 2, 1972. The defendants failed to pay anything despite the bank writing numerous letters to them. The bank further claims that originally the rate of interest was 10.5% per annum and because of enhancement in the bank rate by the Reserve Bank of India, the interest chargeable from the defendant also stood enchanced and the defendant had agreed to be bound by the various rules and regulations of the bank regarding enhancement of interest and the same has been charged at the rate of 16.5 per cent. per annum and has been computed accordingly in the statement of accounts filed in the suit. Accordingly, it is claimed that a sum of Rs. 33,39,026.75 is due from and payable by the defendants to the bank.

2. The written on behalf of defendant No. 1 was filed about four years after service of summons on the said defendant. Although adjournment was taken to file a written statement on behalf of other defendants, no written statement was filed. The plea taken by defendant No. 1 in written statement is that the said defendant become a sick unit and as such is not liable to pay any interest. The averments made in the plaint were not specially controverter as required by rule 5 of Order 8 of the Code of Civil Procedure. The rate of interest was also not specifically controverter nor execution of the various documents. The substance of the plea of defendant No. 1 is given in additional pleas taken in the written statement in the following words :

> "That the answering defendant took diverse amount from the plaintiff bank from time to time which are subject-matter of this suit as well as the other suits, filed by the plaintiff. The answering defendant is always ready to pay the principal amount and being a sick unit, it is not liable to pay any interest. The answering defendant became a sick unit but although it has since substantially recovered but is still a sick unit for purposes of payment of the amount, which is subject-matter of the present suit as well as the connected suits. The plaintiff is, therefore, not entitled to charge any interest and can claim only the principal amount. A proposal has already been submitted by the answering defendant to the plaintiff-bank in which in order to settle the matter the answering defendant has even agreed to the payment of interest at the reduced rate set out in the said proposal."

3. On the pleading of the parties, the following issues were framed:

> "1. Whether the principal amount as claimed by the bank is not the principal amount on the ground that it includes interest added from the date of advance till date of the suit ? If so, what is its effect ?
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> 2. Whether there are special circumstances for disallowing interest payable to the plaintiff from the date of the filing of the suit to the date of the decree and from the date of the decree till the date of the payment and, in any case, for charging the same at reduced rate or rates of interest ?
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> 3. Whether the amount paid by the defendant during the pendency of this suit is liable to be adjusted against the principal amount or towards interest ?
>
> 4. Relief ."

4. The order framing issues specially records that parties do not desire any other issue to be framed. It was further agreed that evidence will be by affidavits. As the onus for all the issues was on the defendants, they were directed to file affidavits first by was of evidence. The bank had filed various suits against the defendants on similar averments. For the purpose of trial, Suits Nos. 348 of 1980, 806 of 1979, 1412 of 1979, 807 of 1979, 1345 of 1979, 687 of 1979, 729 of 1979, 735 of 1979, 1098 of 1979, 343 of 1979, and 1374 of 1979 were consolidated and the main evidence was directed to be taken in the present suit. By orders made on April 11, 1986, the defendants were directed to file

affidavits by way of evidence by April 30, 1986, and the case was directed to be listed for cross-examination of the deponents, if disired, on May 12, 1986, and also for arguments. The defendants did not file affidavits by way of evidence within time granted by the court. By order made on May 16, 1986, the defendants were granted a last opportunity to file their affidavits by way of evidence by July 10, 1986, and the case was listed for arguments for July 25, 1986. On July 23, 1986 it was noticed that in spite of the last opportunity granted, the defendants had not filed the affidavits and, accordingly, the case was fixed for August 13, 1986, for further proceedings. On August 13, 1986, again a request was made for grant of time to file affidavits by way of evidence which request was declined. Thereafter, on some dates, arguments were heard but the case had to be adjourned to September 30, 1986, as the documents which had been kept in a sealed cover were not traceable. The orders passed on March 6, 1987, show that the record had been traced and, accordingly, the case was fixed for further hearing on April 9, 1987. It appears that in between the defendants filed affidavit of Shri B. K. Sahni along with an application for condensation of delay in filing the said affidavit by way of evidence. In view of the fact that further proceedings had not taken place as the record was not traceable and the affidavit had already been placed of record, the court, by orders made on July 28, 1987, condoned the delay in filing the said affidavit.

5. I have heard learned counsel for the parties in support of the issues. The primary questions for determination are: (i) scope of section 34 of the Code of Civil Procedure including interpretation of the words "principal sum" in the said section, and; (ii) from the date of the decree to the date of payment, where the liability has arisen out of a commercial transation, the grant of interest at the contractual rate, should be the rule or a rare execption. Now, the issues:

6. Issue No. 1.-Mr. P. C. Khanna, learned counsel for the defendants, has vehemently contended that the defendants are not liable to pay interest to the plaintiff on the suit amount. The argument is that, in fact, the suit amount is not the principal sum because it includes interest added from the date of advance till the date of the suit. The thrust of the arguments of learned counsel is that only the amount of initial advance is the principal sum and under section 34 of the Code of Civil Procedure, after the institution of a suit, interest can be awarded, in the discretion of the court, only on the principal sum and not on the amount inclusive of interest from the date of advance till the date of the suit. It may be mentioned that the liability of the defendants to pay the suit amount has not been disputed. The dispute is about the amount on which interest is leviable after the filing of the suit till the date of the decree and from the date of the decree to the date of the payment.

7. It is well-settled that interest for the period prior to suit is payable either under an agreement or iasge or under a statutory provision or under the Interest Act and in some cases it can also be awarded by courts of equity. There is no dispute about the award of interest for the period prior to the institution of the suit. After the institution of the suit, the award of interest is governed by the provisions of section 34 of Code of Civil Procedure. Under this section, after institution of the suit, the court has descretion to order payment of interest on the principal sum adjudged.

8. What is the principal sum? is the amount initially advanced that can alone be treated as the "principal sum", as contended by Mr. Khanna, learned counsel for the defendants or is the amount advanced inclusive of the interest the "principal sum", as contended by Mr. Dewan learned counsel

for the plaintiff?

9. The defendants did not dispute that as on December 31, 1974, they had acknowledged their liabilities to the extent of Rs. 11,83,327.95 and as on December 31, 1976, the liabilities of Rs. 17,38,401.85. The statement of account also shows that the bank computed interest with quarterly rests. After a quarter, the interest was added to the last balance and that amount was treated as the "principal sum" for computing interest for the next quarter and so on and so forth. Learned counsel for the plaintiff submitted that if interest is not paid by the due date by the borrower which under the contract, he is liable to pay, a concession is given to the borrower by adding the amount of such interest to the amount of last balance and the sum total of the two becomes the principal sum. In support, learned counsel has placed reliance on a Division Bench judgment of the Madras High Court in P. C. T. L. Lakshmanan Chettiar v. K. T. RM. KR. RM. Karuppan Chettiar [1978] 2 MLJ 364 for the proposition that the principal at the beginning of each year would be the principal plus interest which accrued during the previous year. The Bench held that the contract between the parties has to be worked out as a whole and it cannot be interpreted in a truncated fashion and, therefore, the interest calculated on the amounts arrived at annually would be the principal for the next year. Mr. Khanna is not right in submission that the said judgment is not applicable as it was based on contract and in the present case the plaintiff bank has not proved any contract. The plaintiff-bank had levied interest in the manner stated above which was not challenged. The only specific plea taken in the written statement is that the defendant is not liable to pay interest because it was a sick unit. The onus of this issue is on the defendants who had to show how under the contract, the amount inclusive of interest was not the principal sum. They have not led any evidence to prove this issue. In the affidavit of Mr. Sahni, reliance has been placed only on the provisions of section 34. No contract has been either pleaded or proved showing that the amount inclusive of interest cannot be treated as the "principal sum". On the suit amount, no issue was even claimed. The issue claimed was only on the amount and rate at which interest was payable after the institution of suit. It was neither argued nor could it be argued that the defendant is not liable to pay the suit amount. The only argument was that the defendant is not liable to pay interest on the suit amount but on the amount of the initial advance. In view of above, it is not possible to accept the submission of Mr. Khanna that there was no contract for including interest in the amount of initial advance and treating it as the "principal sum".

10. In support of the submission that only the amount of the original advance is the principal sum and the amount inclusive of interest con not be treated as the "principal sum", learned counsel for the defendants has placed reliance on judgment of the House of Lords in Paton v. IRC [1938] AC 341. While analysing the facts, the points in dispute and the ratio of Paton's case [1983] AC 341 (HL), it is to be born in mind that the dispute in the said case was not between a debtor and a creditor or between a bank and its customer but was one between an individual and a revenue commissione, i.e., tax collecting agency. Briefly, the facts of the said case are that one Mr. Fenton had loan accounts with National Bank Limited and Halifax Commercial Banking Company Ltd. (subsequently, the Bank of Liverpool and Martins, Ltd.) on which he had drawn large sums. The practice of the banks was to debit Mr. Fenton's accounts at the close of each half-year with the interest accrued and to carry the balance forward to the next half-year. As the balance carried forward included the amount of the interest accrued in the preceding half-year, the result was that

the interest debited at the end of the next half-year included interest on the interest accrued in the preceding half-year. In effect, by thus adding interest to the principal halr-yearly, the banks charged Mr. Fenton with compound interest. As regards the loan accounts which Mr. Fenton had with the Halifax Commercial Banking Company Ltd., in each of the calender years 1920 and 1921 when interest fell due half- yearly on June 30, and December 31, Mr. Fenton did not make any payment to the bank, and the bank, at the end of each half-year, simply debited the accounts with the accrued interest and carried the balance forward, charging interest at the end of the succeeding half-year on the accumulated principal and interest and so on. Mr. Fenton claimed that the action of the bank in debting with his consent to his loan accounts half-yearly period of the interest and carrying forward the accumulated sum constituted, as between him and the bank, payment at each half- yearly period of the interest then falling due. He, accordingly, maintained that in the tax year up to April 5, 1921, he had in this way paid 27076 10s 10d of interest to the bank, without deduction of tax, on the bank's advances to him. As, after allowing for deductions and repayments, he paid income-tax for the year up to April 5, 1921, on 7777, he claimed that the sum of 27076 10s 10d of interest had, to the extent of 7777, been paid out of profits or gains brought into charge to tax, and that he was accordingly entitled to repayment of tax on 7777 under section 36, sub-section (1) of the Income-tax Act, 1918. He submitted similar calculations for the fiscal year up to April 5, 1922, bringing out a claim for repayment for that year of tax on 2722. Section 36 of the aforesaid Act on which reliance was placed by Mr. Fenton reads as under :-

> "(I) Where interest payable in the United Kingdom on an advance from a bank carrying on a bona fide banking business in the United Kingdom is paid to the bank without deduction of tax out of profits or gains brought into charge to tax, the person by whom the interest is paid shall be entitled, on proof of the facts to the satisfaction of the special commissioners, to repayment of tax on the amount of the interest."

11. The question for determination before the House of Lords was whether there was any payment by Mr. Fenton of the interest in respect of which repayment of tax was claimed by him under the aforesaid provision. The Court of Appeal had held that Mr. Fenton had paid or must be deemed to have paid the interest in question. This finding of the Court of Appeal was under challenge before the House of Lords. Another ancillary question was whether the payment was out of profits or gains brought into charge to tax. However, in the present case, we are not concerned with the said ancillary question. The House Lords, while interpreting the aforesaid provision, held that the payment of interest could not be notional but it had to be paid in reality in order to become entitled to refund. Lord Atkin expressed the opinion that "in circumstances such as the present there is no ground for holding that the interest in question was paid by Mr. Fenton". Similar opinions were also expressed by the other Law Lords. The ratio of Paton's case [1938] AC 341 (HL) is not that only the amount of original advance is the principal sum in a dealing between a bank and its customer. It rather opined to the contrary. Lord Atkin, in his opinion, has recognised the practice of adding interest to the sum advanced then charging interest on the sum total of the two as the principal sum in the following words :

> "The privilege of a banker to balance the account at the end of the year and accumulate the interest with principal is founded on this plain ground of equity, that

> the interest ought then to be paid, and, because it is not paid, the debtor becomes thenceforth a debtor in the amount, as a principal sum itself bearing interest."

12. Similarly, Lord Macmillan opines that "Now it may well be that as between a bank and its customer, this method of dealing may have the result that the accrued interest which the bank has with the customer's assent added to the principal loan thereby ceases to be due or recoverable as interest but becomes merged in the principal loan".

13. From the aforesaid discussion, it is evident that Mr. Fenton was not held entitled to refund of the tax under the provisions of section 36 as interest in reality had not been paid by him but that is not the question with which we are concerned in this suit. The opinion on the question with which we are concerned was against the borrower, like the defendant, and the method of dealing with loan accounts and adding interest to the amount advanced and treating the merged amount as the principal loan was recognised.

14. The defendants have not been able to show how the suit amount claimed is not the "principal sum". It cannot be inferred that it is not the principal sum because it includes interest from the date of the advance till the date of the suit. As stated above, the defendants have neither pleaded nor proved any contract under which the plaintiff could be precluded from claiming the principal amount in the manner claimed by it. I cannot accept the general statement that the amount of initial advance will always remain the principal sum and interest will always remain interest and the two can never merge. The definition of the word principal sum as given in various dictionaries is not relevant for the word principal sum as given in various dictionaries is not relevant for the purpose of adjudging the principal sum under section 34. It will depend upon the contract between the parties. If the contention of the defendants is accepted, the contract to pay interest with rests will become meaningless. Reference may also be made to the decision of the Allahabad High Court in Jafar Husain v. Bishambhar Nath . This was case under Order 34, rule 11 of the Code of Civil Procedure. Under Order 34 rule 11, a mortgage is entitled to interest on the principal amount found or declared due on the mortgage. While interpreting the words "on the principal amount found or declared due", the Division Bench of Allahabad High Court held that the mortgage is entitled to interest at the contract rate from the date of the suit till the date fixed for the payment. If the mortgage deed provides that interest will be calculated six monthly and if it was not paid, then it would become a part of the principal, the that agreement will have to be enforced. It was further held that Order 34, rule 11, does not provide the rate at the time of calculating the dues to the mortgagee, and interest will be allowed only on the principal sum secured by the deed and not on the interest which, according to the agreement between the parties, had become the part of the principal on the date on which accounts are taken. Referance may also be made to the Division Bench decision of the Madras High court in Sigappiachi v. M. A. P. A. Palaniappa Chettiar, , where Justice Kailasam, speaking for the Bench, held that the "principal sum adjudged" is the amount found due as on the date of the suit. In view of the above discussion, it is not possible to accept the contention of Mr. Khanna, learned counsel for the defendants, that interest can never become principal and the words principal sum in section 34, Code Civil Procedure, should be given the ordinary meaning as given in didctionaries. It follows that the argument that the interest under section 34 can be awarded only on the original sum advanced is misconceived. The interpretation sought to be placed by Mr. Khanna

would also run counter to the normal banking practice and act as premium for those not paying the amount of interest when it is due at the costs of those making payment of interest when it is due. I will conclude the discussion on this issue by reproducing the plea taken by the defendants in the affidavit of Mr. B. K. Sahni in the following words :

> "Even though a bank for the purpose of its book-keeping adds interest to the principal periodically and then treats the principal and interest as principal and during the next calculating period (whether quartely, six monthly or yearly) treats the principal plus interest as principal, but under the Code of Civil Procedure the principal amount remains separate as it was at the time when the first loan was granted and interest over interest remains separate. The two channels, that is principal and interest and interest over interest, flow closely but never merge and do not become one".

15. In view of the above discussion, I answer issue No. 1 against the defendants and adjudge Rs. 33,39,026.75 as the principal sum.

16. Issue No. 2.- Mr. Khanna, learned counsel for the defendants, vehemently urged that, as a matter of rule, the courts should learn in favor of awarding a reduce rate of interest after the date of suit as that is the scheme of section 34. It is true that under section 34, a wide discretion has been conferred on the courts in the matter of grant of interest. But it is equally true that the discretion is to be exercised not arbitrarily but no sound judicial principles. In this case, we are concerned with the scope of section 34 in regard to the grant of interest at two stages, viz., (1) from the date of the suit to the date of the decree, i. e., pendente lite interest ; and (2) from the date of decree to the date of paym,ent i.e., future interest or further interest. Pendente lite interest can be awarded at such rate as the court deems reasonable. Further interest can be awarded at such tate not exceeding 6% per annum. But under the proviso to section 34, the rare of such further interest may exceed 6% per annum, where the liability in relation to the sum so adjudged had arisen out of a commercial transaction, but such rate shall not exceed the contractual rate of interest, or where there is no contractual rate, the rate at which monies are lent or advanced by nationalised banks in relation to commercial transactions. Explanation II states that a transaction is commercial transaction, if it is connected with the industry, trade or business of the party incurring the liability. Prior to 1956 amendment, interest pendente lite or further interest could be awarded at such rate as the court deemed reasonable. The upper limit of grant of further interest at the rate of 6% was incorporated by amendment of section 34 made in the year 1956. Before the 1976 amendment of the Code of Civil Procedure, further interest could be awarded at such rate not exceeding 6% per annum as the court deemed reasonable. The said upper limit has continued for all transactions except where the liability has arisen out of a commercial transactions except where the upper limit is the contractual rate of interest and in the absence of a contractual rate, the rate at which monies are lent or advanced by nationalised banks in relation to commercial transactions. It cannot be disputed that in the present case the liability has arisen out of a commercial transaction. It is also true that, in a given case, even in respect of a liability arising out of commercial transactions, courts can grant further interest at a rate less than the contractual rate or even disallow it altogether. The courts can also disallow pendente lite interest. The question for determination, however, is whether after the amendment of

1976, for liabilities arising out of commercial transactions, should the contractual rate of interest be the rule or an exception. Of course, Mr. Khanna contends that as a rule, grant of interest should not exceed 6% per annum and only in exceptional cases, the courts should exercise discretion under the proviso to grant further interest on the contractual rate. If the contention of Mr. Khanna is accepted, the amendment of 1976 would become more or less illusory. The very purpose of the amendment would be lost, if as a matter of rule, interest is awarded at a rate not exceeding 6% per annum in commercial transactions. The grant of interest at a rate less than the contractual rate, as matter of rule, will amount to giving a premium to those who trade upon the money of others. The defaulting borrower, in my opinion, cannot be given the benefit of the reduced rate of interest as a matter of rule only because the bank had to resort to legal recourse on account of non-payment by the borrower except of course in exceptional circumstances. The existence of exceptional or special circumstances will depend on the facts and circumstances of each case. One such illustration of exceptional or special circumstances can be where the borrower made every sincere effort to pay but failed and grant of interest at the contractual rate will result in closure of his unit resulting in unemployment of a large number of persons. Another such illustration can be the conduct of the creditor himself which may justify the grant of a reduced rate of interest. I will not venture to lay down any broad proposition by multiplying these illustrations. Ultimately, the facts of each case will determine the special or exceptional circumstances. No rigid or hard and fast rule can be laid down. In my opinion, in commercial transactions, grant of interest at the contractual rate ought to be the rule principles should be applied for determining the reasonable rate of pendente lite interest. The special circumstances for disallowing interest to the plaintiff from the date of filing the suit to the date of decree and from the date of the decree till the date of the payment, or charging interest at the reduced rate, on which reliance has been placed by the defendants, are as set out in their additional pleas where primarily the emphasis is on defendant No. 1 being a sick unit. The plea taken is that although the defendant has substantially recovered it is still a sick unit for the purpose of payment of interest which is the subject-matter of the present suit as well as the connected suits. It is not disputed that defendant No.1 has not been statutorily declared as a sick unit. The affidavit of Mr. B. K. Sahni shows that the company paid to other creditors a sum of about rupees two crores which included payment to the Bank of Madura, Punjab National Bank, statutory creditors like sales tax and other departments and sundry creditors. Another affidavit dated August 11, 1988, filed by Shri Seshagiri Rao, corporate manager of defendant No. 1, shows that over Rs. 1.2 crores was spent by the company between July 1984 and August, 1985, for acquiring some other unit. These averments show the genuineness of the defendant's claim of being a sick unit. As stated above, the plea even in the written statement about the defendant company being a sick unit has been taken in a guarded language when it is stated "although it has since substantially recovered but is still a sick unit for the present suit as well as in the connected suits". The defendants have not placed on record any other evidence except the two affidavits referred to above in support of its claim that there are special circumstances for either waiving the interest or awarding it at a reduced rate from the date of payment. The defendants have not placed on record their balance-sheets or accounts or any other documents in support of their plea of existence or special circumstances for awarding a reduced rate of interest.

17. It cannot be said that there are any special circumstances justifying the grant of interest at a reduced rate. I have also set out above the conduct of the defendants. The written statement was

filed nearly four years after service of summons. The affidavit by way of evidence was not filed in spite of grant of a last opportunity. The affidavit by way of evidence was not filed in spite of grant of a last opportunity. The request for grant of further time was declined but still the court permitted the placing of the said affidavit on record as by the time the affidavit was filed, the arguments could not be concluded because the record was not traceable. The totality of the circumstances show that the defendants have not been able to show any exceptional or special circumstances justifying reduction of rate of interest and not awarding it at the rate 16.5% per annum. The plaintiff claimed interest at this rate. There is no specific denial by the defendants. It has neither been pleaded nor proved that the contractual rate of interest is not 16.5% but is less. The defendants did not join issue with the plaintiffs in respect of the contractual rate of interest. The bank rate of interest is also not less than 16.5% per annum. Even if the conduct of the defendants is ignored, then also, they will not be entitled to reduction of the rate of interest as no special or exceptional circumstances have been established.

18. For the aforesaid reasons, I answer issue No. 2 against the defendants and hold that there are no special circumstances for either disallowing interest or allowing at a reduced rate.

19. Issue No. 3.-It has been disputed that during the pendency of the suit, the defendants have paid Rs. 7,40,000 to the plaintiff bank in the year 1983-84. A sum of Rs. 5,00,000 was paid by cheque dated May 29, 1984, handed over in court to counsel for the plaintiff on May 30, 1984, and realised on June 2, 1984. It is also not disputed that a sum of Rs.2,40,000 was paid by the defendants to the plaintiff in or about September, 1983. It is also not disputed that along with the aforesaid payment totalling Rs. 7,40,000 the defendants did not give any special instructions to the plaintiff as to how the said amount was to be adjusted. Under section 60 of the Indian Contract Act, 1872, in the absence of any instructions from the defendants, the bank could apply it at its discretion to any lawful debt actually due and payable to it from the defendants. The defendants have not led any evidence showing that they had instructed the bank that the amount of Rs. 7,40,000 be adjusted towards the principal amount. The bank admits that adjustment of this amount is to be given but urges that it is to be adjusted towards principal. The defendants, in law, cannot insist that this amount is liable to be adjusted against the principal amount in the absence of any such instruction to the bank. Accordingly, the defendants con not claim that the amount of Rs. 7,40,000 is liable to be adjusted against the principal amount. Issue No. 3 is decided accordingly.

20. Issue No. 4.-Relief.-For the reasons aforesaid, I pass a decree in favor of the plaintiff and against the defendants for a sum of Rs. 33,39,026.75 with interest thereon at the rate of 16.5% per annum from the date of suit to the date of realisation.