

V.G.P. Finances Limited vs The Official Liquidator on 20 September, 2013

Author: V.Ramasubramanian

Bench: V.Ramasubramanian

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 20-09-2013

CORAM

THE HON'BLE MR. JUSTICE V.RAMASUBRAMANIAN

Company Application No.1324 of 2009
in
Company Petition No.201 of 1996

V.G.P. Finances Limited,
VGP Square, 6, Dharmaraja Koil Street,
Saidapet, Chennai-600 015
Represented by its Director,
Mr.VGP.Raja Doss.
Vs.

.. Applicant

1. The Official Liquidator,
High Court, Madras, as Liquidator of
Neptune Inflatables Limited (in liquidation)

2. Indian Bank
rep. by its Chief Manager S.Srihari Rao
Asset Recovery Management Branch
Circle Office Buildings
4th Floor, No.55, Ethiraj Salai
Chennai 600 008.

.. Respondents

(R2 impleaded by order dated 17.11.2009
made in Comp.A.No.1594 of 2009)

For Applicant : Mr.T.K.Seshadri, S.C.
For Mr.Shivakumar

For Respondent -1 : Mr.Arvind Shukla, Official Liquidator

For Respondent -2 : Mr.R.Yashod Vardhan, S.C.
For Mr.R.Sunil Kumar

For unsecured creditors : Mr.C.K.M.Appaji

O R D E R

This is an application filed by the purchaser of a property, seeking validation of the transaction in terms of Section 536(2) of the Companies Act, 1956.

2. I have heard Mr.T.K.Seshadri, learned Senior Counsel for the applicant, Mr.Arvind Shukla, learned Official Liquidator, Mr.R.Yashod Vardhan, learned Senior Counsel appearing for the Indian Bank and Mr.C.K.M.Appaji, learned counsel appearing for one of the unsecured creditors.

3. The ICICI Venutre Funds Management Limited, filed a petition in C.P.No.201 of 1996 against the company-in-liquidation, on 14.10.1996 under Section 433(e) and (f) of the Act, for the winding up of the company. The petition for winding up was allowed by a learned Judge, by an order dated 13.3.1998. But by a judgment dated 9.6.1998, passed in OSA No.85 of 1998, a Division Bench of this Court set aside the order of winding up, on the sole ground that the winding up order was passed without directing the publication of advertisements, in terms of Rules 24 and 96 of the Companies (Court) Rules, 1959. The Division Bench remanded the matter back to the Company Court.

4. Thereafter, an advertisement was issued and a paper publication was effected on 21.11.1998. Following the same, an order for winding up of the Company was again passed by the Company Court on 10.3.1999. The order of the Company Court dated 10.3.1999 was confirmed by the Division Bench in OSA No.85 of 1998, by an order dated 14.7.1999. This order has attained finality and the Company in question stands wound up.

5. After the order of winding up passed by the Company Court on 10.3.1999, which was confirmed by the Division Bench on 14.7.1999, the applicant in this application viz., VGP Finances Limited, filed an application in C.A.No.1275 of 1999, seeking a direction to the Official Liquidator to deliver possession of a property, bearing No.5/259, Old Mahabalipuram Road, Thoraipakkam, Chennai-96. The claim of the applicant in this application was -

(i) that in pursuance of a Master Loan Agreement entered into on 11.12.1995 by the company-in-liquidation with the applicant, the applicant sanctioned loans to the company-in-liquidation under 4 separate loan agreements dated 1.1.1996, 30.1.1996, 7.2.1996 and 10.1.1997;

(ii) that for the loans availed by the company-in-liquidation under the aforesaid 4 agreements, the Company created a mortgage of the aforesaid property in favour of the applicant on 31.1.1997 and the charge so created in favour of the applicant was registered with the Registrar of Companies, on 5.2.1997;

(iii) that thereafter, the company-in-liquidation sold the property to the applicant, under two different Sale Deeds dated 11.2.1999 and 16.2.1999 respectively;

(iv) that the Official Liquidator took possession of the properties of the company-in-liquidation on 8.6.1999, in pursuance of the order for winding up; and

(v) that therefore, the applicant was seeking a direction to the Official Liquidator to hand over possession back to them.

6. The above application C.A.No.1275 of 1999 was earlier dismissed for default on 14.8.2002, but it was subsequently restored. After restoration, the applicant also filed another application, but in the year 2004, seeking validation of the dispositions made by the company-in-liquidation under the two Sale Deeds dated 11.2.1999 and 16.2.1999 respectively. But the said application filed in September 2004 was not numbered for a long time.

7. Therefore, the application for possession filed in C.A.No.1275 of 1999 alone came up for hearing before the Company Court. By an order dated 29.11.2004, the Company Court dismissed the said C.A.No.1275 of 1999 filed by the applicant for possession. But the said order of the Company Court was set aside by a Division Bench, by an order dated 7.3.2005 made in OSA No.13 of 2005 and the application C.A.No.1275 of 1999 was remanded back to the Company Court, for deciding the validity of the sale, on the basis of evidence let in by both parties.

8. After the order of remand by the Division Bench, the application C.A. No.1275 of 1999 was again taken up for hearing by the Company Court and the same was allowed by a learned Judge by an order dated 9.8.2005. In this order, the Company Court found that the sale was liable to be validated and that the applicant was entitled to possession.

9. Challenging the order of the Company Court dated 9.8.2005, allowing C.A.No.1275 of 1999, 3 creditors, including the second respondent herein, filed 3 appeals in OSA Nos.201, 210 and 211 of 2005. These appeals were dismissed by the Division Bench, by an order dated 9.9.2008. But in the meantime, the possession of the property was handed over to the applicant. However, the Division Bench restrained the applicant from demolishing any structure or removing any machinery.

10. As against the dismissal of their appeal, the second respondent, viz., the Indian Bank filed a special leave petition in SLP(Civil) No.28177 of 2008, on the file of the Supreme Court. The Supreme Court granted leave and eventually allowed the civil appeal C.A.No.2934 of 2009 filed by the second respondent herein (Indian Bank), by an order dated 24.4.2009 and directed this Court to take up the application for validation filed in September 2004 and hear the same and dispose it of after taking note of the availability of assets and the claims of secured and unsecured creditors.

11. It must be pointed out at this stage that the Company Court as well as the Division Bench treated C.A.No.1275 of 1999 itself as an application for validation, though the prayer therein was only for possession and though the applicant had also taken out a separate application for validation in 2004. The fact that the company Court treated C.A.No.1275 of 1999 itself as an application for

validation can be seen from the fact that in the first round, the Division Bench remitted the matter back to the Company Court only on the basis of the decision of the Supreme Court in Pankaj Mehra and the Company Court as well as the Division Bench in the second round, dealt with the prayer of the applicant only on the parameters of Section 536(2).

12. But while reversing the order of the Company Court and the Division Bench, the Supreme Court pointed out that C.A.No.1275 of 1999 was only an application for possession and that the actual application for validation filed in September 2004 should be numbered and dealt with afresh by the company court after taking into account the interests of the creditors. This is how the present application filed in September 2004, got numbered in 2009, after the order of remand passed by the Supreme court. Since this application is taken up for hearing in pursuance of the order of remand passed by the Supreme Court, it will be useful to extract the operative portion of the order of the Supreme Court, so that the decision on this application is taken on the basis of the guidelines found therein. Hence the operative portion of the order dated 24-4-2009 passed by the supreme court is extracted as follows:-

"On going through the entire record we find that both, the Company Court as well as the Division Bench, have not taken into account some of the vital aspects which a Company Court is statutorily required to take into account. Firstly, in the impugned judgments there is no reference to the interest of other secured and unsecured creditors of the Company. Generally, while granting validation the Company Court is required to take into account the list of assets held by the Company in liquidation. It appears that in this case apart from the subject lands there are no other assets except goodwill. This aspect is very important. If a Company does not possess any other assets than the interest of the creditors, both secured and unsecured, would be jeopardized if the transfer is validated. In this case it appears that Indian Bank was not heard. It was not even made a party. The Court has not examined the list of creditors both secured and unsecured whose security/ claims would stand defeated on validation of the sale deed. Moreover, it is important to note that there was no prayer for validation in Company Application No.1275 of 1999 and even without said prayer the Court has allowed validation which was erroneous. The High Court has also not considered the question regarding commencement of the winding up proceedings and whether the conveyances stood executed after such commencement?

However, to put an end to the controversy, we are restoring to the file of the Company Judge the application dated 13th September, 2004 moved by the respondent No.1 herein for validation. We direct the Company Registrar to give a proper registration to the Company Application for validation dated 13th September, 2004. On giving the registration number we give liberty to respondent No.1 herein, if so advised, to move an application for amendment giving better particulars in support of his claim. We also direct the Company Registrar to inform the Indian Bank regarding the application being numbered as directed hereinabove. On completion of all these preliminaries we direct the Company Court to dispose of the Application for validation dated 13th September, 2004 after considering the claims of

secured and unsecured creditors as well as after taking into consideration assets held by the Company in liquidation as on the date of order of winding dated 10th March, 1999, and thereafter. We also give permission to Indian Bank to make an application for impleadment in such application.

.....

We direct the High Court to de novo decide this matter uninfluenced by any of its earlier observations made in the impugned judgment. We express no opinion on the merits of the case. We grant liberty to both sides to make submissions in support of their case."

13. Thereafter, the application filed in September 2004 by the applicant under Section 536(2), got numbered as C.A.No.1324 of 2009. It is this application that is sought to be disposed of by this order.

14. While the above application was pending, an unsecured creditor represented by Mr.C.K.M.Appaji, learned counsel, filed an application for impleading himself as a party. Instead of allowing his impleading application, I heard the arguments of Mr.C.K.M.Appaji also, in the application for validation C.A.No.1324 of 2009.

13. Mr.T.K.Seshadri, learned Senior Counsel appearing for the applicant submitted that the prayer of the applicant for validating the sale in favour of the applicant in terms of Section 536(2) of the Act, is justified on the following grounds:-

(i) that much before the institution of the winding up petition on 14.10.1996, the company-in-liquidation entered into a Master Agreement on 11.12.1995, in pursuance of which loans were advanced under 3 Loan Agreements dated 1.1.1996, 30.1.1996 and 7.2.1996;

(ii) that a fourth loan agreement was entered on 10.1.1997, for a subsequent loan and a mortgage was created on 31.1.1997 and the charge was entered in terms of Section 125 on 5.2.1997;

(iii) that the Sale Deeds dated 11.2.1999 and 16.2.1999 have to be seen in the context of the 3 loan agreements under which the applicant lent monies to the Company much before the date of institution of the winding up petition;

(iv) that in the background of the above facts, the applicant is a bona fide transferee, of the property in question, for a valuable consideration, without notice of the filing of the winding up petition;

(v) that though the first application filed by the applicant in C.A.No.1275 of 1999 was only for delivery of possession, the Division Bench, which disposed of the first

original side appeal in OSA No.13 of 2005, understood and treated the application to be one for validation of the transaction;

(vi) that even the Division Bench, which disposed of the subsequent appeals OSA Nos.201, 210 and 211 of 2005, considered the application only as an application for validation;

(vii) that the Official Liquidator did not ever come up with any application for setting aside the sale under Section 536(2) on the ground that the sale was intended to defeat the body of creditors; and

(viii) that therefore the applicant is entitled to have the transaction ratified.

14. In response to the above contentions, Mr.R.Yashod Vardhan, learned Senior Counsel appearing for the Indian Bank (second respondent) contended -

(i) that none of the 4 loan agreements dated 11.1.1996, 30.1.1996, 7.2.1996 and 10.1.1997 ever contemplated the creation of any mortgage and hence, the creation of the mortgage on 31.1.1997, after the admission of the company petition for winding up on 14.10.1996, exposed the true intent of the parties;

(ii) that the publication of the admission of the company petition for winding up, was effected on 21.11.1998, only after which the applicant obtained the sale of the properties under two deeds dated 11.2.1999 and 16.2.1999, showing thereby that the sale was intended to allow one creditor (applicant herein) to score a march over a host of creditors;

(iii) that there was no averment in the earliest application filed by the applicant viz., C.A.No.1275 of 1999 that the applicant was a bona fide transferee;

(iv) that even the recitals contained in the Sale Deeds show that the Company had suffered huge losses, which gave a clear indication that the transaction was not in the ordinary course of business of the Company;

(v) that both the Sale Deeds show that there was gross undervaluation of the property, which belie any colour of bona fides;

(vi) that in order to get a transaction validated, a person should plead and prove bona fides, establish that the transaction was in the ordinary course of business of the Company and that the transferee did not gain an unfair or undue advantage over other creditors; and

(vii) that since the applicant could not prove the above 3 tests, the applicant is not entitled to validation.

15. Mr.C.K.M.Appaji, learned counsel appearing for one of the creditors submitted that the mala fide nature of the transaction is writ large on the face of the record, as seen from the fact that the property was purchased in 1996 for Rs.9 lakhs, but the sale in 1999 was for Rs.4 lakhs. He also contended that there was no Resolution of the General Body for the sale of the property.

16. I have carefully considered the above submissions.

17. Section 536(2) of the Companies Act, 1956 declares any disposition of the property of the Company and any transfer of shares in the Company or alteration in the status of its members, made after the commencement of the winding up as void. But the declaration so made is a qualified declaration, in view of the fact that the last portion of sub-Section (2) of Section 536 contains a rider in the form of the phrase "unless court otherwise orders". Therefore, it has become an usual practice, either for the Official Liquidator to seek to set aside a transaction made after the commencement of the winding up as void or for any transferee to seek the validation of a disposition of property, made after the commencement of the winding up.

18. As seen from the admitted facts, the following are the sequence of events that have happened in this case:-

(i) The Company-in-liquidation entered into a Master Loan Agreement dated 11.12.1995 with the applicant, whereby the applicant agreed to provide finances to the Company;

(ii) In pursuance of the Master Agreement, the applicant lent monies and 3 loan agreements were executed on 1.1.1996, 30.1.1996 and 7.2.1996, much before the date of filing of the petition for winding up on 14.10.1996;

(iii) The fourth loan agreement was entered into thereafter on 10.1.1997 and the mortgage was created on 31.1.1997; and

(iv) The sale took place under two Sale Deeds dated 11.2.1999 and 16.2.1999, much after the publication of the advertisement about the admission of the company petition on 21.11.1998.

19. Therefore, it is clear that the date of commencement of the winding up is 14.10.1996. The date of creation of the mortgage was 31.1.1997, which was subsequent to the date of commencement of winding up. The dates of sale viz., 11.2.1999 and 16.2.1999 were also subsequent to the date of commencement of the winding up. Therefore, the question to be decided is as to whether the disposition of property, is liable to be validated or not.

20. The circumstances under which the disposition of a property made after the commencement of the winding up, can be validated or declared invalid, have been settled for a long time, by a catena of decisions of various Courts, including this Court and the Supreme Court. But since the learned Senior Counsel on both sides relied upon various decisions, it is my duty to refer to them. Therefore,

I shall do so in brief, as follows:-

(i) In *Official Assignee of Madras vs. Valliappa Chetti* {AIR 1922 Mad. 144}, which arose under the Presidency Towns Insolvency Act, a Division Bench of this Court held that to be a bona fide transferee, a person should have had no notice of the presentation of the insolvency petition, at the time when the transfer took place.

(ii) In *Tulsidas Jasraj Parekh vs. Industrial Bank of Western India* {AIR 1931 Bom. 2}, a Division Bench of the Bombay High Court pointed out while considering the effect of Section 227(2) of the 1913 Companies Act (which is equivalent to Section 536) that generally any bona fide transaction carried out and completed in the ordinary course of current business will be sanctioned by the Court and that the Court will not allow any disposition of assets at the mere pleasure of the company, thereby causing the fundamental principle of equality amongst creditors to be violated.

(iii) In *Ram Lal vs. Official Liquidator* {AIR 1942 All. 141}, a learned Judge of the Allahabad High Court held that the assets of the company shall be, so far as is possible and subject to certain well recognised exceptions, distributed pari passu between the creditors and subject to the principle that no creditors shall obtain an advantage over any other creditor. The Court also pointed out that if it was not a case of salvage, of real necessity nor of the transaction having been the only means of keeping the company going, then it cannot be sanctioned by the Court ex post facto.

(iv) In *The Andhra Bank vs. Narayana Rao* {1954 (2) MLJ 38}, this Court held that the real test in these types of cases, is to find out whether the Court would have sanctioned the transaction, supposing it had been asked to do so at the time when the transaction was entered into. The Court also added that such disposition, intended to preserve the business as a going concern, will be approved by the Court.

(v) In *M.K.Ranganathan vs. Government of Madras* {AIR 1955 SC 604}, the Supreme Court held that it is only when the intervention of the Court is sought either by putting in force any attachment, distress or execution within the meaning of Section 232 (1) of the 1913 Act or proceeding with or commencing a suit or other legal proceedings against the company within the meaning of Section 171 that leave of the Court is necessary. But when a secured creditor, standing outside the winding up realises his security without the intervention of the Court, by effecting a sale of the mortgaged property by private treaty or public auction, he need not even seek the leave of the Court.

(vi) In *Syed Haidar Sahib vs. M.Jayaram Pillai* {(1956) 26 CC 164 (Mad.)}, a learned Judge of this Court held that paying a creditor by assigning an asset of the company, especially after the commencement of the winding up, cannot be considered to be a bona fide transaction arising in the ordinary course of current business.

(vii) In *N.Subramania Iyer vs. Official Receiver* {AIR 1958 SC 1}, the Supreme Court pointed out that the onus is upon the Official Assignee to prove that a conveyance which he was seeking to set aside, was not made in good faith or for valuable consideration. The Court further pointed out that even if the transferor (or mortgagor) was found to be wanting in bona fides, the Court cannot set aside a transaction, unless it is found that the transferee was wanting in bona fides in respect of the transaction in question. The Court also pointed out that "annulment proceedings are aimed at transactions between a debtor who has become insolvent and a creditor who, knowing the true state of the debtor's crashing business, has taken undue advantage of the embarrassed financial position of the debtor". The Court added further that in such cases "the test of honesty is more appropriate than the test of due care and attention".

(viii) In *Navjivan Mills Ltd., in Re*, {(1986) 59 CC 201}, a Division Bench of the Gujarat High Court referred to various decisions including that of the Bombay High Court in *Tulsidas*, and held that the purpose underlying the investment of the power under Section 536(2) is for the benefit and interest of the company so as to ensure that a company which is made the subject of a winding up petition may nevertheless obtain money necessary for carrying out its business and to avoid its business being paralysed.

(ix) In *Chittoor District Cooperative Marketing Society Ltd vs. Vegetols Ltd* {1987 (Supp.) SCC 167}, the Supreme Court pointed out that any payments made after the commencement of winding up, cannot be validated unless they are shown to have been made bona fide under a commercial compulsion in the course of transactions necessitated for the running of the business.

(x) In *K.N.Narayana Iyer vs. Commissioner of Income Tax* {(1993) 78 CC 156}, a Division Bench of the Kerala High Court held that a transfer falling within Section 531-A of the Companies Act, 1956, is void as against the Liquidator, but that it is not a nullity in the absolute sense. Consequently, the Division Bench held that when the Official Liquidator himself did not choose to avoid the transfer or recover the property, it is not open even to the Income Tax Department to treat the transfer as void.

(xi) In *N.Babu Janardhanam vs. Official Liquidator* {(1993) 78 CC 490}, a Division Bench of this Court held that the initial burden is cast by Section 531-A, upon the person who denies the charge to establish that the transaction was not made in the ordinary course of business of the company or that it lacked good faith. Once the initial onus is discharged, then it will shift upon the creditor.

(xii) In *Pankaj Mehra vs. State of Maharashtra* {2000 (2) SCC 756}, the Supreme Court pointed out that any disposition of property made after the presentation of the winding up petition would not be void ab initio, but that it is only voidable. Citing

with approval, the decision of the Bombay High Court in *Tulsidas*, the decision of the Gujarat High Court in *Navjivan Mills*, and also its own decision in *Chittoor District Cooperative Marketing Society*, the Supreme Court held that a company may have to deal with very many day-to-day transactions, make payments of salary to the staff and meet urgent contingencies and that therefore, all transactions cannot be held to be ab initio void.

(xiii) In *ICICI Ltd vs. Ahmadabad Manufacturing and Calico Printing Co. Ltd* {2004 (9) SCC 747}, the Supreme Court rejected the prayer of a creditor of a company-in-liquidation, for creating a first charge on the properties of the company. While doing so, the Supreme Court pointed out that leave under Section 536(2) can be granted either for the benefit of the company-in-liquidation or for the benefit of the creditors of the company in general. More importantly, the Supreme Court indicated in para 4 of its decision that "the securing of old debts due to one creditor of the company-in-liquidation, by creating a mortgage ex post facto, could not be said to be in any way enuring towards the preservation of the company's assets or its business or enuring to the benefit of its other creditors".

(xiv) In *NGEF Ltd vs. Chandra Developers* {2005 (8) SCC 219}, the Supreme Court cited with approval the decision in *Pankaj Mehra*, and held that though a disposition of assets after the commencement of winding up may not be irretrievably void, the Courts are required to exercise the power under Section 536(2) with circumspection and caution. In paragraphs 60 and 61, the Supreme Court summarised some principles, which require to be noted:-

"60. There lies a distinction between accord of sanction for private negotiation of sale of assets of the Company vis-a-vis the auction held by the Official Liquidator. It is not in dispute that no Provisional Liquidator was appointed. The court may have an inherent power to approve a transaction of sale entered into by and between the Company and the third party; but it is beyond any cavil of doubt that while doing so the Company Court must bear in mind its duties towards the creditors. While exercising jurisdiction under Section 433 of the Companies Act, the Company Court remains the custodian of the interest of the Company and its creditors. It has, thus, a duty to satisfy itself that having regard to the market value of the property, the price offered is reasonable. [See *Kayjay Industries (P) Ltd.* (1974) 2 SCC 213]. It is further more required to be borne in mind that upon liquidation, the assets and properties of the Company vest in the Official Liquidator for the benefit of its creditors. {See *Allahabad Bank vs. Bengal Paper Mills Co. Ltd* [(1999) 4 SCC 383]}.

61. The satisfaction as regards adequacy of the price is one of the relevant factors for proper and reasonable exercise of the judicial discretion vested in it. There cannot be any doubt or dispute that when an auction is held upon compliance of the statutory provisions, withholding of auction on the ground that a still higher price may be obtained may prove to be a self-defeating exercise as has been held in *M/s Kayjay*

Industries (P) Ltd. (1974) 2 SCC 213] and State of Punjab vs. Yoginder Sharma Onkar Rai & Co. [(1996) 6 SCC 173], but having regard to the accepted position that the Company Judge in a case of this nature exercises a discretionary jurisdiction; it is bound to act with great circumspection and caution. Such a jurisdiction should ordinarily be exercised in exceptional cases and when necessary for seeing the company as an ongoing concern."

(xv) In K.Periyasamy Gounder vs. Kothari Industrial Corporation Ltd {2010 (1) CTC 62}, I had an occasion to consider some of the decisions, including the one in Gray's Inn Construction Co. Ltd {1980 (1) All.E.R.814} and elicited the following principles:-

- (a) that the disposition must be honest and bona fide;
- (b) that the transaction is in furtherance of the company's business/ interests and in the interest of the creditors; and
- (c) that no creditor should obtain an advantage over his fellow creditors.

(xvi) Again in M.Lakshmi Narayana Choudhary vs. Official Liquidator {Company Application No.125 of 2011 decided on 30.4.2013}, I had an occasion to consider the very same issue and after listing out the case law cited, I formulated the principles of law that emerged out of them, as follows:-

- (a) that the discretion granted to this Court under Section 536(2) can be exercised in favour of a bona fide transferee;
- (b) that the bona fides of a transferee cannot be impeached merely on account of the dishonesty of the transferor; and
- (c) that for finding out if a transferee is a bona fide transferee or not, the test of honesty is more important than the test of due care.

21. Keeping in mind the above principles of law, if we now get back to the facts of the case, it is seen that the company-in-liquidation entered into a Master Agreement on 11.12.1995 with the applicant herein, whereby the applicant agreed to sanction a maximum loan of Rs.70 lakhs to the company-in-liquidation, subject to the terms and conditions contained in the Master Agreement. Clauses 3 and 4 of the Master Agreement indicated that the borrower will create security, as required by the lender, in the form of the assets of the borrower.

22. Thereafter, the first loan agreement was entered into on 1.1.1996, whereby a sum of Rs.10 lakhs repayable on the expiry of 365 days from the date of disbursement was advanced by the applicant to the company-in-liquidation. Interestingly, Clause 5 of the said agreement merely stated that the borrower would secure the repayment of the loan, by way of personal guarantee of the Managing Director, by name Pradeep Ranganathan and the personal guarantee of S.N.Natarajan, by pledging

their share certificates for twice the value of the loan taken. No immovable property was either offered or even contemplated to be offered as security under the first loan agreement.

23. The second loan agreement was entered into on 30.1.1996, whereby a sum of Rs.25 lakhs was advanced. Similarly, a third loan agreement was entered into for a further loan of Rs.25 lakhs, on 7.2.1996 and a fourth loan agreement was entered into on 10.1.1997 for a short term loan of Rs.5,20,901/-.

24. The second and third loan agreements also contained the same Clause 5 as found in the first loan agreement. In the fourth loan agreement, there was no such clause. Clause 5, as pointed out earlier, merely obliged the borrower to offer the personal guarantees of two persons by name Pradeep Ranganathan and S.N. Natarajan, as security for the due repayment of the loan, by pledging their share certificates.

25. In other words, though the Master Agreement dated 11.12.1995 contemplated the creation of securities in the assets of the company, all the 4 loan agreements that followed, did not extract any immovable property of the company as security.

26. But all of a sudden, after the presentation of the winding up petition on 14.10.1996, which is the date of commencement of the winding up, the Managing Director of the company makes a declaration on 31.1.1997 in the form of an affidavit, creating a mortgage by deposit of title deeds. Two interesting things are noticed in the declaration dated 31.1.1997, a copy of which is filed by the applicant themselves. They are:-

(i) It is typed on non-judicial stamp paper of the value of Rs.10/-, but the name of the person to whom the non-judicial stamp paper was issued, is conspicuously absent.

(ii) The mortgage is created in respect of an antecedent debt, borrowed under 4 earlier agreements, mentioned above.

27. Therefore, it is clear that as on the date of commencement of winding up, viz., 14.10.1996, the applicant herein was an unsecured creditor. The applicant was elevated to the level of a secured creditor, only on 31.1.1997 and that too, not after borrowing any money for the continuation of day-to-day operations of the company, but after the winding up petition was filed. In other words, the creation of the mortgage on 31.1.1997 did not bring any benefit to the company, so as to enable it to continue its day-to-day operations, without getting paralysed, by the initiation of winding up. The only person to whom a benefit accrued out of the creation of the mortgage was the applicant herein.

28. After 2 years of the creation of the mortgage, the property is sold under 2 Sale Deeds dated 11.2.1999 and 16.2.1999. The sales took place after the publication of the advertisements in the newspapers, of the admission of the company petition for winding up on 21.11.1998.

29. The recitals contained in the 2 Sale Deeds also reveal certain interesting facts. They are:-

(i) As per the recitals contained in both the Sale Deeds, the property was mortgaged to the applicant herein by a Deed of Mortgage dated 29.1.1997 registered as document No.393/97 in the office of the Sub Registrar of Assurances, Neelangarai. But even according to the pleadings and the Deed of Declaration, dated 31.1.1997, what was created was only an equitable mortgage by deposit of title deeds, made on 31.1.1997. This fact is also confirmed by Form No.8 filed under Section 125 of the Companies Act, 1956. In Column No.1 of Form No.8, the company-in-liquidation indicated the date and description of the instrument creating the charge as 31.1.1997 and "deposit of title deeds" respectively. Therefore, it remains a mystery as to how suddenly a mention is made in the 2 Sale Deeds, about a registered mortgage deed dated 29.1.1997. The registered mortgage deed has not seen the light of the day till date.

(ii) Both the Sale Deeds contain a recital to the effect that the company-in-liquidation had sustained huge losses in their business activities and that therefore, they are unable to repay the mortgage loan. The first Sale Deed contains a recital to the effect that in partial discharge of the mortgage loan of Rs.5 lakhs, one portion of the property was sold thereunder for a consideration of Rs.2,37,180/-. The second Sale Deed contains a recital to the effect that in partial discharge of the mortgage loan of Rs.5 lakhs, another portion of the property was sold thereunder for a consideration of Rs.3,16,080/-. Therefore, it is clear that no consideration passed under both the Sale Deeds. The only consideration for the company-in-liquidation executing the 2 Sale Deeds, was a partial discharge of the mortgage loan. Therefore, it is clear that the company did not stand to benefit in any way, by these 2 Sale Deeds. These 2 Sale Deeds did not ensure any cash flow to the company or any tangible benefit to the company, to keep the company alive and kicking.

(iii) The Sale Deeds also disclose that under the first Deed of Sale, the land of the extent of 6 grounds and 1404 sq. ft., in Survey No.265/2 in old No.148, New No.135, Mootaikkaran Chavadi, Okkiyam Thoraipakkam village was sold for a stated consideration of Rs.2,37,180/-. Under the second Deed of Sale, the land of the extent of 2724 sq. ft., in Survey No.267/2A and 1635 sq. ft., in Survey No.268/2A in old No.148, New No.135, Mootaikkaran Chavadi, Okkiyam Thoraipakkam village was sold for a stated consideration of Rs.3,16,080/-. In other words, a larger extent was sold for a lesser price and a smaller extent was sold for a higher price, within a gap of 5 days.

(iv) Interestingly, in the Statement under Rule 3(1) of the Madras Stamp (Prevention of Undervaluation of Instrument) Rules, 1968, the Managing Director of the company-in-liquidation declared the market value of the property sold, to be much higher than the sale consideration. This is in respect of the first Sale Deed. When this was pointed out by the learned Senior Counsel for the Indian Bank, the learned Senior Counsel for the applicant relied upon a decision of the Full Bench of this Court in Sakthi & Co. vs. Sri Desikachari {CDJ 2006 MHC 1089} to the effect that the

guideline value of a property, is not to be confused with or taken to be representing the market value. But I think the reliance placed on the decision of the Full Bench is not very apposite, for the simple reason that even the market value as declared by the Managing Director of the company-in-liquidation in the Statement under Rule 3(1), was much higher, in so far as the first Sale Deed is concerned. Today, the applicant, who is a purchaser under the very same document, cannot go back on the declaration made by their vendor to the effect that the market value was higher than the sale consideration fixed.

(v) Interestingly, the company-in-liquidation had purchased this property only under a Sale Deed dated 16.2.1996 registered as document No.818 of 1996 in the Office of the Sub Registrar of Adyar. The total sale consideration paid by the company-in-liquidation under the said document was Rs.7,72,000/-. But the total sale consideration adjusted by the company-in-liquidation, under the 2 Sale Deeds in favour of the applicant, executed exactly 3 years later, on 11.2.1999 and 16.2.1999, was only Rs.5,53,260/-. The property is in a very prime locality in the suburbs of Madras, where the market value was sky rocketing every year. Therefore, it is unimaginable that a company which purchased the property in such a locality in 1996, sold it in 1999 for a price lesser than the original purchase price. Coupled with the fact that not a single penny passed as a consideration under the documents, the Sale Deeds speak for themselves more eloquently on the question of bona fides of the transaction.

30. As pointed out earlier, my endeavour in an application for validation of a transaction, in terms of Section 536(2) of the Act, should be to see -

- (i) Whether the transaction was a bona fide one?
- (ii) Whether it was carried out and completed in the ordinary course of current business?
- (iii) Whether it was a case of salvage, of real necessity, to help the company keep going?
- (iv) Whether the transferee viz., the applicant herein, was wanting in bona fides, if the test of honesty is applied rather than the test of due care and attention?
- (v) Whether the transaction was out of a commercial compulsion to prevent the day-to-day running of the company getting paralysed?
- (vi) Whether the transaction was for securing old debts, in order to enable one creditor to score a march over the others?
- (vii) Whether this Court would have approved of such a transaction had its permission been sought at the time when the transaction was entered into?

(viii) Whether the price for which the property was alienated was adequate, with reference to its market value?

31. My answer to all the above questions, would undoubtedly be, against the applicant. Neither the transaction appears to be a bona fide one nor the applicant appear to be a bona fide transferee. The reasons for this conclusion of mine are as follows:-

(i) Though the Master Agreement dated 11.12.1995 contained a clause to the effect that the company-in-liquidation should offer its assets as securities, whenever the loan amounts were disbursed, all the 4 loan agreements that followed, viz., the agreements dated 1.1.1996, 31.1.1996, 7.2.1996 and 10.1.1997 did not contemplate the creation of any security in any immovable property. These agreements contemplated only the offer of personal guarantees by the Directors and the pledging of their share certificates in favour of the applicant. This is perhaps due to the fact that the property in question was bought by the company-in-liquidation only under the Sale Deed dated 16.2.1996, much later than the 3 out of 4 loan agreements.

(ii) The stamp paper on which the declaration dated 31.1.1997 was made by the Managing Director of the company-in-liquidation, indicating that a mortgage by deposit of title deeds had been created, does not bear the name of any person in whose favour it was issued.

(iii) Though the admitted case of the applicant is that the mortgage was an equitable mortgage by deposit of title deeds and though this fact is also indicated both in the declaration dated 31.1.1997 and in the Form 8 filed with the Registrar of Companies, the Sale Deeds executed on 11.2.1999 and 16.2.1999 proceed on the basis as though a registered mortgage deed came into existence on 29.1.1997 itself.

(iv) The execution of the Sale Deeds appears to have happened under extremely suspicious circumstances. Even without going into the adequacy of consideration, it is seen from both the Sale Deeds that the vendor and the purchaser had gone through the process in such a great hurry and haste, that it belies any bona fide even on the part of the applicant. In the first Sale Deed, the land of the extent of 6 grounds and 1404 sq. ft., is sold for a consideration of Rs.2,37,180/-, but the market value is indicated by the parties themselves, in the Statement under Rule 3(1) as Rs.3,16,080/-. In contrast, the land of the extent of about 4359 sq. ft., is sold under the second Sale Deed, for a sale consideration of Rs.3,16,080/-, but the market value is indicated in the Statement under Rule 3(1) as Rs.2,37,180/-. In other words, what was indicated as the sale consideration in the first Sale Deed was stated as the market value for the second Sale Deed and what was stated as the market value in the first Sale Deed is declared as the sale consideration in the second Sale Deed. This shows the extreme haste and urgency in which the documents had come to be executed.

(v) Moreover, both the Sale Deeds are executed for the stated purpose of discharging a single mortgage loan of Rs.5 lakhs. The total sale consideration adjusted under both the documents, towards the said mortgage loan, was Rs.5,53,260/- (Rs.3,16,080/- + Rs.2,37,180/-). If these recitals are true, the applicant herein should have paid the difference between the sale consideration under both the documents and the mortgage loan sought to be discharged. There is no indication in either of the 2 documents as to what happened to the balance amount of Rs.53,260/-.

Therefore, all these extremely suspicious circumstances, create such a huge cloud over the entire transaction that it is impossible for me to look at the applicant as a bona fide transferee.

32. The transaction is also not carried out and completed in the ordinary course of the current business of the company. On the date on which a mortgage was created on 31.1.1997, the company-in-liquidation did not borrow any money. The last borrowing was on 10.1.1997. Even on the said date, the intention of the applicant as well as the company-in-liquidation was only to offer the personal guarantee of the Directors and the pledging of their shares as a security for the loan amount. The company petition was filed on 14.10.1996. Therefore, at least if some loan had been taken by the company on 31.1.1997, the date of creation of the mortgage, I can believe that some money was borrowed to enable the company after the commencement of the proceedings, to keep going. But, unfortunately, not a single penny was advanced on 31.1.1997, the date of creation of the mortgage. Similarly, not a single penny was paid on the dates of execution of Sale Deeds. The Sale Deeds do not reflect the payment of a single penny. On the contrary, if we go by the recitals contained in the Sale Deeds, the only object of the sale was to adjust a total consideration of Rs.5,53,260/- towards a mortgage loan of Rs.5 lakhs. If at least there was a recital in the Sale Deed that the difference between the sale consideration and the amount due under the mortgage was paid, I can give the benefit of doubt to the applicant and come to the conclusion that that amount was utilised for running the day-to-day business of the company.

33. When not a single penny was paid either under the Deed of Mortgage or under the Sale Deeds, both of which had taken place after the commencement of the winding up, it is clear that neither the mortgage nor the Sale Deeds were for keeping the company going or entered into in the ordinary course of current business. The mortgage as well as the Sale Deeds appear to be the products of an extraneous compulsion rather than a commercial compulsion to prevent the company from getting paralysed. The transactions had taken place only for discharging an antecedent debt and not for enabling the company to keep going. Since the mortgage as well as the sale had taken place only to discharge an antecedent debt, it is clear that one unsecured creditor suddenly scored a march over the others by this process. Therefore, the tests indicated in paragraph 30 (ii), (iii), (v) and (vi), are not satisfied for me to approve the transaction.

34. If on 31.1.1997 or in February 1999, the applicant had come up before me for permitting the company to proceed with the mortgage, I would certainly not have given a nod, since the only object of the transaction was to benefit the applicant and not to benefit either the company-in-liquidation or its creditors.

35. As a matter of fact, I have carefully avoided applying the test of bona fides from the point of view of the company-in-liquidation. I have not even applied the test of bona fides upon the applicant, from the point of view of due care and attention. I have simply applied the test of honesty to find out whether the applicant, as a transferee, could be said to have acted honestly. The applicant has failed this test, in view of the highly suspicious circumstances surrounding the execution of the mortgage and the execution of the Sale Deeds.

36. As pointed out by the Supreme Court in NGEF Limited, adequacy of consideration is also one of the relevant factors for proper and reasonable exercise of the judicial discretion vested under Section 536(2). When this test is applied, the transaction miserably fails. As pointed out earlier, the company-in-liquidation purchases this property in February 1996 for a total sale consideration of Rs.7,72,000/-. But the company sells it to the applicant in February 1999 (exactly after 3 years), for a total sale consideration of Rs.5,53,260/-. But even this payment is purported to have been adjusted towards the discharge of the mortgage loan. Therefore, the transaction does not pass even the test laid down by the Supreme Court in NGEF Limited.

37. Therefore, for all the reasons stated above, this application is dismissed as devoid of merits. Consequently, the Official Liquidator is permitted to take back possession of the property from the applicant. Since the applicant was handed over possession only by this Court, in pursuance of an earlier order passed in their favour, the applicant is duty bound to re-deliver possession to the Official Liquidator.

38. The application is dismissed with the above directions. However, there will be no order as to costs.

20-09-2013

Index : Yes.
Internet : Yes.
Svn

V. RAMASUBRAMANIAN, J.
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Order in

20-09-2013