

CASE NO.:
Appeal (civil) 4785 of 1998

PETITIONER:
STANDARD CHARTERED BANK

Vs.

RESPONDENT:
THE CUSTODIAN & ORS.

DATE OF JUDGMENT: 17/04/2001

BENCH:
S.P. Bharucha, N. Santosh Hegde & Y.K. Sabharwal.

JUDGMENT:

(With CA Nos.6088/98 & 425/99)

J U D G M E N T
L...I...T.....T.....T.....T.....T.....T.....T..J

SANTOSH HEGDE, J.

These appeals are filed against the judgment and order dated 20th July, 1998 passed by the Special Court at Bombay constituted under the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992 (for short the Act). Though by the impugned order, the High Court has decided a number of questions raised before it, the appellants before us have confined their argument to the following questions;

(a) whether the interest claimed by them is liable to be disbursed under Section 11(2)(b) of the Act on a preferential basis or the same is to be distributed under Section 11(2)(c) of the Act;

(b) do the secured creditors have the right to stand outside the distribution under Section 11 of the Act and recover their dues.

Section 11 of the Act reads thus:

Discharge of liabilities(1) Notwithstanding anything contained in the Code and any other law for the time being in force, the Special Court may make such order as it may deem fit directing the Custodian for the disposal of the property under attachment.

(2) The following liabilities shall be paid or discharged in full, as far as may be, in the order as under:--

(a) all revenues, taxes, cesses and rates due from the persons notified by the Custodian under sub-section (2) of Sec. 3 to the Central Government or any State Government or any local authority.

(b) all amounts due from the person so notified by the

Custodian to any bank of financial institution or mutual fund; and

(c) any other liability as may be specified by the Special Court from time to time.

The High Court came to the conclusion in regard to the claim of interest by the appellants that the same cannot be distributed on priority basis under Section 11(2)(b) of the Act, but same can be done under Section 11(2)(c) of the Act. In regard to this finding, the appellants contend that in view of the wording of sub-section (2) of Section 11, they are entitled not only to the principal amount due to them but also to the interest that has become payable thereon, therefore, they are entitled for the payment under Section 11(2)(b) of the Act. On behalf of the Custodian, it is argued that the amount payable to the appellants, be it the principal or interest, can be only such amount and interest thereon as became due within the period stipulated in the Act, that is, the notified period being 1.4.1991 and 6.6.1992. Therefore, it is contended that the appellants are not entitled to the interest payable on the amount due to them which falls outside the notified period. It is the case of the Custodian that the interest that becomes payable outside the notified period, can be claimed only under Section 11(2)(c) of the Act.

Having considered the arguments of the parties, we are of the opinion that the contention advanced on behalf of the Custodian merits acceptance. It is to be seen that this Court in *Harshad Shantilal Mehta v. Custodian & Ors.* (1998 5 SCC 1) while examining the claim of the Revenue for payment on priority basis under Section 11(2)(b) of the Act regarding the amounts due under the heads penalty and interest had held thus :

Since the liabilities covered under Section 11(2)(a) are only liabilities arising during the period 1.4.1991 to 6.6.1992, and do not cover penalty and interest, the question whether the Special Court can absolve a notified person from imposition of penalty or interest after the date of the notification does not really arise. In any case, interest or penalty for any action or default after the date of the notification, are not covered by the Act. x x x The Special Court is required to consider this question only from the point of view of distributing any part of the surplus assets in the hands of the Custodian after the discharge of liabilities under Sections 11(2)(a) and 11(2)(b). The Special Court has full discretion under Section 11(2)(c) to decide whether such claim for penalty or interest should be paid out of any surplus funds in the hands of the Custodian.

Though the said judgment was delivered with reference to the claim made by the income-tax authorities, the said ratio is applicable to the claim made by the appellants in these appeals so far as their claim for interest is concerned.

It is to be noted also that when the Special Court was considering the claim of the Revenue for payment of interest and penalty due from the notified persons under Section 11(2)(b) of the Act, these very appellants had contended that any interest or penalty which became due outside the notified period could only be distributed by the Custodian under Section 11(2)(c) of the Act. We are of the opinion

that the stand taken by the appellants in that case is the correct one and the same should apply to their claim in these appeals also. Therefore, so far as the appellants claim for interest is concerned, in our opinion, if the interest fell due within the notified period, the same shall be distributed on the basis of the priority contemplated under Section 11(2)(b) of the Act, and so far as their claim for interest which fell due outside the notified period is concerned, the same can be entertained by the Custodian only under Section 11(2)(c) of the Act.

In regard to the next contention pertaining to secured creditors, some of whom are the appellants in this batch of appeals, it is to be noted that the Special Court held that they are not entitled to stand outside the distribution under Section 11 of the Act, hence, they will have to claim the amounts due to them under Section 11(2) of the Act. The argument on behalf of such secured creditors is that the property secured in their favour is not attachable by the Custodian; hence, the proceeds from such security cannot be utilised for distribution under Section 11(2) of the Act. They contend that these properties which are secured in their favour cannot be treated as the properties belonging to a notified person, and that their interest in the said property cannot be sold or distributed to discharge the liability of the notified person.

This Court in Harshad Shantilal Mehtas case (supra) has held :

If in the property belonging to a notified person, another person has a share or interest, that share or interest is not extinguished. Of course, if the interest of the notified person in the property is not a severable interest, the entire property may be attached. But the proceeds from which distribution will be made under Section 11(2) can only be the proceeds in relation to the right, title and interest of the notified person in that property. The interest of a third party in the attached property cannot be sold or distributed to discharge the liabilities of the notified person. This would also be the position when the property is already mortgaged or pledged on the date of attachment to a bank or to any third party. This, however, is subject to the right of the Custodian under Section 4 to set aside the transaction of mortgage or pledge. Unless the Custodian exercises his power under Section 4, the right acquired by a third party in the attached property prior to attachment does not get extinguished nor does the property vest in the Custodian whether free from encumbrances or otherwise. The ownership of the property remains as it was.

Therefore, we are of the opinion that so far as the secured creditors are concerned, subject to the right of the Custodian under Section 4 of the Act, they are entitled to recover the amounts due to them (principal and interest) from the property secured in their favour without taking recourse to Section 11 of the Act. But if the security is not large enough to extinguish their debt, they can seek payment of the shortfall only under section 11(2) of the Act.

For the reasons stated above, these appeals are partly allowed, to the extent indicated hereinabove. No costs.

1

1

JUDIS