

GAJRAJ JAIN
v.
STATE OF BIHAR AND ORS.

MAY 7, 2004

[RUMA PAL AND S.H. KAPADIA, JJ.]

State Financial Corporation Act, 1951; Section 29 :

Recovery of loan/advance taken by a company from State Financial Corporation and a Bank—Default in repayment—Petition for recovery of dues filed by the Bank—Issuance of notice by the Corporation for sale of assets by auction to realize its dues—Payment of dues to the Corporation by a Director of the company—Corporation did not return the assets and misappropriated the amount—However, it entered into an agreement of sale of the assets with a financier on payment of its dues and on making promise to pay dues of the Bank—Challenge to—Dismissed by the High Court—On appeal, Held: Corporation had entered into an agreement for sale without ascertaining the market value of the assets—It failed to take proper steps to secure best price of the assets—Since sale consideration was not realized in full, the Corporation neither complied with the provisions of the Act nor has it protected the interest of the Bank—Since the Corporation did not return the assets to the Company even after liquidation of the dues and returned the tender money, the Corporation intended to sell the assets to the financier for extraneous considerations and thus acted arbitrarily—Hence, the agreement for transferring assets to the financier set aside—Amount paid by the Company which was appropriated by the Corporation has to be taken to the account of the Company—Dues of the Corporation shall stand repaid—District Judge directed to restore possession of the assets to the Company and suggest recovery in case of short fall, if any—Corporation directed to return back the amount received from the financier—Directions issued—Transfer of Property Act, 1882; Sections 69-100.

'Charge' and 'mortgage'—Distinction between—Discussed.

Words and Phrases :

A 'Best possible price'—*Meaning of in the context of State Financial Corporation Act, 1951.*

'Equity of redemption'—*Meaning of in the context of Section 69 of the Transfer of Property Act.*

B A Flour Mill promoted by a Group of promoters took a term loan from Bihar State Credit and Investment Corporation Limited (BICICO). Central Bank of India also advanced certain amount to the Company, Later, an agreement was approved by shareholders of the Company whereby 50% of the paid up capital was transferred to another Groups of promoters. Appellant became a shareholder/Director of the Company. The Company defaulted in re-payment of the dues. The Bank instituted a case against the company for recovery of its dues and BICICO-respondent No. 2 served a notice under Sections 29 and 30 of the State Financial Corporation Act, 1951 for recovery of its dues by way of sale by auction and issued a sale notice for auction of the Flour Mill thereto. First group of promoter had introduced a financier-respondent No. 4, to respondent No. 2. Respondent No. 2 took possession of the assets of the Company and transferred them to respondent No. 4 on payment of its dues and on promising to pay dues of the Bank. In the meanwhile, one of the Directors of the Company made payment of entire dues of respondent No. 2. However, respondent No. 2 had entered into an agreement with respondent No. 4 for sale of the assets. Aggrieved, appellant-Director of the company challenged the validity of the agreement on the ground of collusion between respondent Nos. 2, 3 and 4, which was dismissed and thereafter the appeal was also dismissed by the High Court.

Hence the Present appeal.

Allowing the appeal, the Court

G HELD : 1.1. There is a difference between a charge and mortgage. In the case of a charge under Section 100 of the Transfer of Property Act, there is no transfer of interest in the property. A charge is not a *jus in rem*. It is *jus ad rem*. It creates a right of payment out of the H property/fund charged with the debt or out of proceeds of the

realization of such property, a phrase used in Section 29(1) of the State Financial Corporation Act. A charge as defined under Section 100 of T.P. Act may be enforced by sale. A charge consists in the right of a creditor to receive the payment out of the proceeds of the realization of property or fund charged with the debt. [690-G-H; 691-A, D] A

CPC by Mulla (15th Edition) page 2420, referred to. B

1.2. Section 29(1) of the Act contemplates a sale for distribution of sale proceeds and not a sale for distribution of property charged with the debt. It also implies that the first charge holder must act in a manner which protects not only its own interest but also the interest of the subsequent charge holder and the mortgagor. This in turn implies that the first charge holder is bound to obtain the best possible price for the mortgaged assets and the best possible price must, in the context, mean the fair market value. [691-E-F] C

Rajah Kishendatt Ram v. Rajah Mumtaz Ali Khan, Vol. VI, Indian Appeals 145 (PC), relied on. D

2. In the instant case, the Corporation entered into an agreement for sale of the assets with respondent No. 4 without ascertaining the market value and realizing the sale proceeds for distribution in breach of sub-sections (1) and (4) of Section 29 of the Act. The assets were agreed to be sold for certain amount merely by adding the Corporation dues and the claim of the Bank. Even this sale consideration was not realized in full. The Corporation accepted downright payment of certain amount in settlement of its own dues and the balance sum was received by it in the form of a promise to it by respondent No. 4 to pay the dues of the Bank, which was not even a party of the arrangement. There is no sale for distribution of sale proceeds in terms of Section 29(1) of the Act. There is no realization of the property, charged with debt, in terms of sub-sections (1) and (4) of Section 29 of the Act. The interest of the Bank and the mortgagor is totally defeated by the impugned arrangement between respondents No. 2 and 4. The word "realization of the property pledged, mortgaged, hypothecated" presupposes realization of sale proceeds and application/appropriation thereof to liquidate the dues of the paramount charge- E F G H

A holder and from the surplus payment to persons(s) entitled thereto. It is for this reason that the best possible price has got to be tried for under Section 29 of the Act. Hence, in the circumstances, the impugned agreement of sale as well as the transfer of assets in favour of respondent No. 4 are in breach of Section 29(1) and Section 29(4) of the 1951 Act. [692-A-B-C, F-G-H; 693-A]

M.C. Chacko v. The State Bank of Travancore, Trivandrum, [1969] 2 SCC 343 and Subbu Chetti v. Arunachalam Chettiar, AIR (1930) Madras 382, relied on.

C *Law and Practice of Income Tax by Kanga and Palkhiwala VIIth Edition, p. 47; Mulla and Pullock on Contract Act, XII Edition, p. 106 and Law of Mortgage by Ghose p. 127, referred to.*

D 2.2. Reasonableness is to be tested against the dominant consideration to secure the best price. Value or price is fixed by the market. If the object of Section 29 of the Act is to obtain the best possible price then the Corporation ought to have called for the valuation report. This has not been done. There is no inventory of assets produced before this Court. The mortgaged assets of the company could be sold on itemized basis or as a whole whichever is found on valuation to be more profitable. If publicity and maximum participation is to be attained then the bidders should know the details of the assets (or itemized value). In the absence of the proper mechanism the auction sale becomes only a pretence. Further, the Corporation must have valued the assets at the time of granting advance to the company. At that time, it must have valued the assets. No such report has been produced that the price of the assets is pegged to the dues of the Corporation and the Bank. The assets were agreed to be sold to respondent No. 4 not for the market price but against repayment of dues of the Corporation plus a promise to discharge the liability of the Bank. Therefore, the Corporation had not acted reasonably. It has not taken any steps to secure the best price. In fact it has failed to protect the interest of the Bank, which was having the second charge on the assets transferred to respondent No. 4 as well as the mortgagor which would be entitled to the balance of the sale proceeds, if any. Even assuming for the sake of argument, that there

were no offers except the offer of respondent No. 4, no reason has been given why respondent No. 2 did not insist for downright payment of entire value of the assets. [693-C-D-E-F-G-H; 694-A]

M/s. S.J.S. Business Enterprises (P) Ltd. v. State of Bihar & Ors., (2004) 3 Scale 374.

3.1. The circumstances of the case indicate collusion between respondent No.2 Corporation, respondent No.3 and respondent No. 4. The take over of assets was ordered on 18.3.2002, the assets were handed over to respondent No. 4 against down payment of Rs. 28.85 lacs by way of demand drafts. Under Section 29(1) of the Act, the Corporation is entitled to sell or lease the assets in order to realize the pledged/hypothecated or mortgaged property. There is no explanation as to how respondent No. 4 could have drawn demand drafts in favour of Corporation on 9.3.2002 when their offer to purchase was on 17/19.3.2002. It is alleged on behalf of respondent No. 4 that they were given the assets with a specific understanding of return of property if a higher offer was received in the auction. No such understanding was recited in the minutes of the tender committee nor in the recitals in the impugned agreement dated 25.4.2002. No resolution/minutes of the Board of Directors of the Corporation were found in that regard. Under Section 69 of T.P. Act, equity of redemption existed in favour of the company. A mere agreement for sale of assets cannot extinguish the equity of redemption; it is only on execution of conveyance that the mortgagor's right of redemption will be extinguished. [694-C-D-E-F-G]

Transfer of Property Act by Mulla, p. 794, referred to.

3.2. In the present case, there is no conveyance and, therefore, on 21.3.2002 when appellant paid Rs. 28.85 lacs to the Corporation representing its full dues, there was complete liquidation of the dues of the Corporation and yet the Corporation did not return the assets to the Company and arbitrarily and for extraneous reasons adjusted the said amount to the account of another Mill. Thus, the Corporation intended to sell the assets only to respondent No. 4 for a paltry amount of Rs. 28.85 lacs. No reasons has been given by the Corporation as to why it did not insist on the full payment of Rs. 198.85 lacs. Though,

A the appellant had cleared the dues of the Corporation on 21/3/2002, before opening of tenders on 22.3.2002, and yet the Corporation did not return the assets to company. Even the tender money deposited by the appellant was returned without any demand from the appellant so that it could be argued by the Corporation that the appellant had withdrawn from the auction and therefore the offer of respondent No. **B** 4 was accepted. However, when the appellant had cleared the dues of the Corporation, the company had a right to redeem the assets. The Corporation was required to act in accordance with Section 29 of the 1951 Act and not unreasonably. In this connection, it may be pointed out that under the public notice inviting tenders, the Corporation was **C** obliged to call for matching offers from the directors/promoters/guarantors. The Corporation did not call for such offers as its object was to keep out all counter-offers. That the impugned agreement has been entered into without any consideration in favour of the Bank. Thus, respondent No. 2-Corporation has misused its authority and **D** power in breach of law by taking into account extraneous matters and by ignoring relevant matters which has rendered all its acts *ultra-vires*.
[694-GH; 695-C-D-E-F-G-H; 696-A]

Narandas Karsondas v. S.A. Kamtam & Anr., AIR (1977) SC 774 and *Express Newspapers Pvt. Limited & Ors. v. Union of India & Ors.*, **E** AIR (1986) SC 872, relied on.

4. In the circumstances of the case, agreement dated 26.4.2002 is set aside; respondent No. 2-Corporation is directed to transfer Rs. 28.85 lacs to the account of M/s. Katihar Flour Mills (P) Ltd. consequent **F** upon such appropriation, the loan taken by the said company shall stand repaid. The District Judge is directed to restore possession of the assets to M/s. Katihar Flour Mills (P) Ltd. and to draw-up an inventory of the assets. In case of shortfall, it would be open to M/s. Katihar Flour Mills (P) Ltd. to take such steps as they may be advised. The **G** Corporation is directed to return the amount paid to it by respondent No. 4. [696-B-C-D]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 3063 of 2004.

H From the Judgment and Order dated 12.9.2002 of the Patna High

Court in L.P.A. No. 980 of 2002.

A

With C.P. No. 101/2003 in C.A. No. 3063 of 2004.

Mukul Rohtagi, Additional Solicitor General, Harish N. Salve, Gopal Subramaniam, Jaideep Gupta, G.K. Banerjee, Gopal Jain, R.N. Karanjawala, Ankur Chawla, Amit Mahajan, Ms. Meenakshi Grover, Mrs. Manik Karanjawala, Ms. Indra Sawhney, Rana Mukherjee, Siddhartha Gautam, Mrs. Sarla Chandra, S.B. Upadhyay, Sanjay Sen and Ms. Nandini Gore, for the appearing parties.

B

The Judgment of the Court was delivered by

C

KAPADIA, J. : Leave granted.

The question in this civil appeal by special leave is whether Bihar State Industrial Credit and Investment Corporation Limited (hereinafter referred to as "BICICO") acted *malafide* and in breach of section 29 of the State Financial Corporation Act, 1951 by transferring the assets of the debtor company on 19.3.2002 and executing the agreement dated 26.4.2002 with M/s Stichworth Exports Pvt. Ltd. (respondent no. 4).

D

The facts giving rise to this appeal are as follows:

E

In 1982, a company by the name M/s Katihar Flour Mills (P) Ltd. was incorporated to take over the assets and business of a partnership firm M/s Katihar Flour Mills, a business conducted by Jeloka group. The said company was promoted by Gopi Krishna Jeloka (since deceased), Binod Jeloka and Pradeep Jeloka (since deceased). The company is engaged in the business of manufacturing, processing, buying and selling of all kinds of grains and wheat products. The flour mill is the main asset of the company. It is located in Katihar, Bihar. On 16.5.1988, a term loan of Rs. 90 lacs was taken by the said company from BICICO, a State Financial Corporation within the meaning of the State Financial Corporation Act, 1951 (hereinafter referred to as "the 1951 Act") and a charge was registered under the Companies Act, 1956. At this stage, it is important to mention that Central Bank of India had advanced working capital of Rs. 1.40 crores to the company and therefore, had a second charge on the plant and

F

G

H

A machinery of the company. On 20.10.1993, an agreement was approved by the share-holder of the company in terms of which three directors belonging to Jeloka group resigned and three nominees of the Jain group were inducted. Under the said agreement, 50% of the paid up capital was transferred to Jain group, which deployed Rs. 1.24 crores in the company.

B Accordingly, the appellant became a share-holder of the company. In January, 2001, Central Bank of India instituted case no. 2 of 2001 against the company and its directors for recovery of its dues amounting to Rs. 1.47 crores and for enforcement of security. On 2.2.2002, BICICO-respondent no. 2 gave notice under sections 29 and 30 of the 1951 Act for recovery of its dues of Rs. 28.85 lacs. On 22.2.2002, respondent no. 2

C issued a sale notice for auction of the flour-mill at Katihar in Bihar. Under the said notice, the last date for submitting tenders was 21.3.2002. The tenders were to be opened on 22.3.2002. On 17.3.2002, the Jeloka Group wrote a letter to respondent no. 2 that the company has approached a financier M/s Stichworth Exports Pvt. Ltd. who was willing to pay the dues

D of respondent no. 2 against transfer of the assets of the company in their favour. By a take over notice dated 18.3.2002, respondent no. 2 took possession of the assets of the company. The possession receipt was signed by respondent no. 3. On 19.3.2002, M/s Stichworth Exports Pvt. Ltd., respondent no. 4, wrote a letter to respondent no. 2 offering to acquire the

E assets of the company for Rs. 28.85 lacs plus the dues of Central Bank of India amounting to Rs. 1.70 crores. On the same day, respondent no. 4 made a down payment of Rs. 28.85 lacs and the assets were handed over by respondent no. 2 to respondent no. 4. On 20.3.2002, the appellant herein met the law officer of respondent no. 2. Pursuant to the sale notice dated

F 22.2.2002, the appellant submits his tender on 21.3.2002. He deposits Rs. 1 lac as earnest money. On 22.3.2002, he pays Rs. 28.85 lacs representing the entire dues of respondent no. 2. Despite payment of the full dues by the appellant, respondent no. 2 enters into agreement of sale of assets in favour of respondent no. 4. Aggrieved, appellant moves the

G High Court on 21.5.2002 under Article 226 of the Constitution *inter alia* challenging the validity of the agreement on the ground of collusion between respondents no. 2, 3 and 4. On 22.5.2002, respondent no. 2 returns the earnest money paid by the appellant alleging that he has withdrawn his tender. The appeal therefrom was also dismissed on 3.9.2002. Hence, the

H appellant, representing the Jain group, has come before this Court in appeal by special leave.

Mr. Harish Salve, learned senior counsel appearing on behalf of the appellant submitted that the impugned agreement dated 26.4.2002 was collusive, arbitrary and contrary to section 29 of the said Act. In this connection, learned counsel relied upon the following circumstances: Firstly, under the public notice dated 22.2.2002, tenders were to be submitted by 21.3.2002 and the offers were to be opened on 22.3.2002 yet the assets came to be handed over by respondent no. 2 to respondent no. 4 on 19.3.2002. Secondly, respondent no. 4 made downright payment of Rs. 28.85 lacs on 19.3.2002. An amount of Rs. 26 lacs was paid by demand drafts dated 9.3.2002. According to the learned counsel, the said date of the demand drafts shows that prior to the commencement of the tender process and prior to the impugned sale agreement, a decision was taken by respondent no. 2 to hand over and sell the assets of the company to respondent no. 4. There was no valuation of the assets prior to acceptance of the bid. Thirdly, under the said sale notice, matching offers were required to be called for from the directors/promoters/guarantors of the company. This was never done. Without inviting matching offers, the assets were handed over to respondent no. 4. Fourthly, despite repayment of dues amounting to Rs. 28.85 lacs by the appellant on 22.3.2002, respondent no. 2 failed to return the assets to the company and arbitrarily appropriated the payment towards dues recoverable by respondent no. 2 from M/s Aditya Flour Mills Ltd. Fifthly, the earnest money amounting to Rs. 1 lac came to be returned to the appellant, after he had filed a writ petition, without any demand from him. It was submitted that the earnest money was refunded in order to enable respondent no. 2 to contend that the appellant has withdrawn his offer and, therefore, the corporation have agreed to sell the assets to respondent no. 4. Lastly, the sale agreement dated 26.4.2002 was entered into in order to defeat the decree which was likely to be passed by the Debts Recovery Tribunal in the suit filed by the Central Bank of India for recovery of its dues. For aforesaid reasons, it was submitted that the sale transaction was collusive, arbitrary and bad in law. That the said transaction was a result of collusion between respondents no. 2, 3 and 4. On the legality of the sale, it was submitted that under section 29(4) of the 1951 Act, respondent no. 2 was duty bound to sell the assets and appropriate the sale proceeds in the first instance to the paramount charge of the corporation and the balance, if any, was required to be held in trust for Central Bank of India, which had the second charge on the

A assets. It was submitted that the impugned sale was in breach of section 29(4) of the said Act and was, therefore, liable to be set aside.

Per contra, Mr. Gopal Subramaniam, learned senior counsel appearing on behalf of respondent no. 3 submitted that there was no merit in this appeal. He contended that one of the terms of the sale notice was that the auction purchaser has to liquidate the dues of Central Bank of India. It was pointed out that respondent no. 2 corporation had handed over the assets of the company to respondent no. 4 who had promised to repay the dues of the company to Central Bank of India. That the said promise was incorporated in the impugned sale agreement dated 26.4.2002. In the circumstances, it was urged that respondent no. 2 had acted fairly, properly, reasonably and in accordance with the provisions of section 29(4) of the said 1951 Act. In this connection, it was also urged that the appellant had withdrawn his offer on 22.3.2002 and after almost one month i.e. on 26.4.2002, the impugned sale agreement came to be executed by respondent no. 2 in favour of respondent no. 4 and consequently, there was no collusion, illegality or arbitrariness in execution of the agreement as alleged. Having withdrawn from the auction, it was urged, the appellant was not entitled to challenge the sale notice, the method of sale as well as the agreement dated 26.4.2002. Learned counsel for respondent next contended that the appellant had come to court with unclean hands. In this connection, it was submitted, on the basis of the correspondence, that the appellant wanted to purchase the assets in his own name for Rs. 28.85 lacs and that he had never offered to clear the dues of respondent no. 2 or Central Bank of India. In this connection, reliance was placed on the undated letter (Annexure R.2/4). For the aforesaid reasons, it was submitted that the civil appeal deserves to be dismissed.

Mr. Gupta, learned senior counsel appearing on behalf of respondent no. 4 submitted that the company became sick by January, 2001 as the appellant had failed to bring in funds to reduce the debts of the company. He submitted that on 22.2.2002, the public notice for auction was issued. Therefore, respondent no. 3 approached respondent no. 4 to take over the assets of the company for Rs. 28.85 lacs along with the amounts due and payable to Central Bank of India. Consequently, on 17.3.2002, the Jeloka Group informed respondent no. 2 that an investor was ready and willing to purchase the assets of the company for Rs. 28.85 lacs plus the dues of

Central Bank of India. On 19.3.2002, accordingly, respondent no. 4 A informed respondent no. 2 that it was prepared to buy the assets with the promise to liquidate the dues of the company to Central Bank of India. Along with the letter, respondent no. 4 paid Rs. 28.85 lacs, against which respondent no. 2 handed over the assets of the company to the purchaser, subject to the understanding that in the event of a buyer being found by B tender process the assets would be returned to respondent no. 2.

Learned counsel for the respondent next contended that the appellant made two offers on 21.3.2002. By the first offer, appellant offered to buy the assets of the company in his own name for Rs. 1.40 crores, which offer C was withdrawn on the same day, followed by the second offer to buy the said assets for Rs. 28.85 lacs. On the same date, there was one more offer from Shri P.K. Jain, which was also withdrawn. In the circumstances, the Tender Committee recorded that since both the offers were withdrawn, the highest offer was from respondent no. 4 and consequently, on 26.4.2002, D the impugned agreement came to be in favour of respondent no. 4 who undertook to discharge the liabilities of the company to Central Bank of India, which had a second charge on the said assets. In the present case, it was submitted that all requisite steps for sale were adequately taken. It was contended that the adequate notice of sale was given; that the offer was kept open for one month; that the bids were received pursuant to the E tender; and when the bids were withdrawn, the auction had failed and in the circumstances, it cannot be suggested that the auction was not properly conducted or that respondent no. 2 did not take steps to obtain the best possible price for the assets or that respondent no. 2 acted unreasonably in selling the assets to respondent no. 4. F

Learned counsel for respondent no. 4 submitted that mere fact that the possession was handed over to respondent no. 4 on 19.3.2002 did not affect the validity of the public auction. In this connection, reliance was placed on section 29 of 1951 Act. It was submitted that after taking G possession, respondent no. 2 was entitled to deal with the property without conducting a sale and that it was open to respondent no. 2 to manage the property in any manner during the pendency of sale. In the circumstances, it was submitted that there was no violation of section 29(4) of the 1951 Act. It was contended that in the present case, at no point of time, was there H any challenge to the procedure adopted by respondent no. 2 prior to the

A sale notice. In the circumstances, the appellant cannot be permitted to question the sale notice or the method of sale. Lastly, it was urged that the first charge in favour of respondent no. 2 was not subject matter of proceedings before the Debts Recovery Tribunal and, therefore, it was not open to Debts Recovery Tribunal to adversely comment on the sale under section 29 of the 1951 Act. In conclusion, it was contended that the impugned sale did not violate sections 29 and 30 of the 1951 Act and that respondent no. 2 - corporation had acted fairly, reasonably and in accordance with law and consequently, no interference was called for under Article 136 of the Constitution.

C Before dealing with the arguments, we may notice the provisions of section 29 of the 1951 Act, section 100 of Transfer of Property Act and the concept of *best possible price* which is dominant consideration for the sale under section 29 of the 1951 Act. We quote herein below section 29 of the 1951 Act: -

D “29. *Rights of Financial Corporation in case of default.*—(1) Where any industrial concern, which is under a liability to the Financial Corporation under an agreement, makes any default in repayment of any loan or advance or any instalment thereof or in meeting its obligations in relation to any guarantee given by the Corporation or otherwise fails to comply with the terms of its agreement with the Financial Corporation, the Financial Corporation shall have the right to take over the management or possession or both of the industrial concerns, as well as the right to transfer by way of lease or sale and realise the property pledged, mortgaged, hypothecated or assigned to the Financial Corporation.

E (2) Any transfer of property made by the Financial Corporation, in exercise of its powers under sub-section (1), shall vest in the transferee all rights in or to the property transferred as if the transfer had been made by the owner of the property.

G (3) The Financial Corporation shall have the same rights and powers with respect to goods manufactured or produced wholly or partly from goods forming part of the security held by it as it had with respect to the original goods.

H

(4) Where any action has been taken against an industrial concern under the provisions of sub-section (1), all costs, charges and expenses which in the opinion of the Financial Corporation have been properly incurred by it as incidental thereto shall be recoverable from the industrial concern and the money which is received by it shall, in the absence of any contract to the contrary, be held by it in trust to be applied firstly, in payment of such costs, charges and expenses and, secondly, in discharge of the debt due to the Financial Corporation, and the residue of the money so received shall be paid to the person entitled thereto. A B

(5) Where the Financial Corporation has taken any action against an industrial concern under the provisions of sub-section (1), the Financial Corporation shall be deemed to be the owner of such concern, for the purposes of suits by or against the concern, and shall sue and be sued in the name of the concern." C D

The above section has been interpreted by this Court in several matters. In the case of *M/s S.J.S. Business Enterprises (P) Ltd. v. State of Bihar & Ors.* reported in [2004 (3) Scale 374], the Division Bench of this Court, to which one of us (Ruma Pal, J.) was a party, while setting aside the impugned sale, observed that: - E

"17. ...It is axiomatic that the statutory powers vested in the State Financial Corporation under the State Financial Corporation Act, must be exercised *bonafide*. The presumption that public officials will discharge their duties honestly and in accordance with the law may be rebutted by establishing circumstances which reasonably probablize the abuse of that power. In such event it is for the concerned officer to explain the circumstances which are set up against him. If there is no credible explanation forthcoming the Court can assume that the impugned action was improper [See: *M/s Pannalal Binjraj & Ors. v. Union of India & Ors.*, AIR 1957 SC 397, 409]. Doubtless some of the restrictions placed on State Financial Corporations exercising their powers under Section 29 of the State Financial Corporation Act, as prescribed in *Mahesh Chandra v. Regional Manager, U.P. Financial Corpn.*, [1993] 2 H F G

A SCC 279, are no longer in place in view of the subsequent decision in *Haryana Financial State Corporation v. Jagdamba Oils Mills*. However, in over-ruling the decision in *Mahesh Chandra*, this Court has affirmed the view taken in *Chairman and Managing Director; SIPCOT, Madras v. Contromix Pvt. Ltd.*, [1995] 4 SCC 595 and said that in the matter of sale under section 29, the State Financial Corporation must act in accordance with the statute and must not act unfairly i.e. unreasonably. If they do their action can be called into question under Article 226. Reasonableness is to be tested against the dominant consideration to secure the best price for the property to be sold. "This can only be achieved when there is a maximum participation in the process of sale and everybody has an opportunity of making an offer. Public auction after adequate publicity ensures participation of every person who is interesting in purchasing the property and generally secures the best price".

D 18. Adequate publicity to ensure maximum participation of bidders in turn requires that a fair and practical period of time must be given to purchasers to effectively participate in the sale. Unless the subject matter of sale is of such a nature which requires immediate disposal, an opportunity must be given to the possible purchaser who is required to purchase the property on 'As is where is basis' to inspect it and to give a considered offer with the necessary financial support to deposit the earnest money and pay the offered amount, if required."

F In the light of the aforesaid judgment of this Court, the issue which arises for determination is -- whether respondent no. 2 corporation acted reasonably and in accordance with section 29 of the 1951 Act in transferring the assets of the company on 19.3.2002 and in entering into agreement for sale with respondent no. 4 on 26.4.2002. As stated above, respondent no. G 2 corporation had a paramount first charge on the assets of the flour mill whereas the Central Bank of India had the second charge thereon. There is a difference between a charge and mortgage. In the case of a charge under section 100 of the T.P. Act, there is no transfer of interest in the property. A charge is not a *jus in rem*. It is *jus ad rem*. It creates a right H of payment out of the property/fund charged with the debt or out of

proceeds of the realisation of such property, a phrase used in section 29(1) A of the 1951 Act. A charge as defined under section 100 of T.P. Act may be enforced by sale [See: *CPC by Mulla* (15th Edition) page 2420]. We have discussed the concept of charge as it has a direct bearing on the interpretation of section 29 of the 1951 Act.

Under section 29(1) of the 1951 Act, where any industrial concern B under a liability to the financial corporation makes any default in repayment of loan, the corporation is empowered to take over possession of the industrial concern and realize the property pledged, mortgaged, hypothecated or assigned to the corporation. Under section 29(4), all costs, charges and C expenses incurred by the corporation as incidental to such realization of the property pledged, hypothecated or mortgaged shall be recovered firstly from the industrial concern and the balance shall be paid to the person entitled thereto. As stated above, a charge consists in the right of a creditor D to receive the payment out of the proceeds of the realization of property or fund charged with the debt. A bare reading of sub-sections (1) & (4) of section 29 shows that it is similar to section 69 of T.P. Act under which it is stipulated that a mortgagee exercising the power of sale is a trustee of the surplus sale proceeds and after satisfying his own charge he holds E the surplus for the subsequent encumbrancers and ultimately for the mortgagor [See: *Rajah Kishendatt Ram v. Rajah Mumtaz Ali Khan* reported in [Vol. VI Indian Appeals 145 (PC)]. Section 29(1) contemplates, therefore, a sale for distribution of sale proceeds and not a sale for F distribution of property charged with the debt. It also implies that the first charge holder must act in a manner which protects not only its own interest but also the interest of the subsequent charge holder and the mortgagor. This in turn implies that the first charge holder is bound to obtain the best G possible price for the mortgaged assets and the best possible price must, in the context, mean the fair market value.

In the present case, it is not in dispute that the assets of the flour mill G were charged. The first charge was in favour of the corporation; whereas the second was in favour of Central Bank of India. Under section 29(1), the corporation while enforcing the first charge was required to put the H assets charged with the debt to sale and apply the sale proceeds in the manner stated in section 29(4). But before doing so, it is imperative to have H

- A the assets proposed to be sold, valued. In breach of sub-sections (1) and (4) of section 29, after putting the assets to sale by public auction the corporation enters into an agreement for sale of the assets with respondent no. 4 without ascertaining the market value and realising the sale proceeds for distribution. The assets are agreed to be sold for Rs. 198.85 lacs merely
- B by adding the corporation dues and the claim of the Central Bank of India. Even this sale consideration is not realised in full. The corporation accepts downright payment of Rs. 28.85 lacs (its own dues) and the balance of Rs. 170 lacs is received by it in the form of a promise to it by respondent no. 4 to pay the dues of Central Bank of India, which is not even a party of
- C the arrangement. According to Law and Practice of Income Tax by Kanga and Palkhiwala [VIIIth Edition page 47], a promise to pay the debt at a future date is no realization. In the case of *M.C. Chacko v. The State Bank of Travancore, Trivandrum*, [1969] 2 SCC 343, it has been held by this Court, that a mere undertaking to discharge an obligation or liability of the debtor may at the highest amount to indemnity, however, it is not enough
- D to charge the property/fund with the debt. Further, according to Mulla and Pullock on Contract Act (XII Edition page 106), contracting parties may confer rights or benefits upon a third party in the form of promise to pay but the third party on whom such right or benefit is conferred by the contract cannot sue under it. Lastly, as stated above, a charge cannot be
- E enforced against a *bonafide* purchaser for value (See: *Law of Mortgage by Ghose* page 127). In the case of *Subbu Chetti v. Arunachalam Chettiar* reported in AIR (1930) Madras 382, it has been held that when a person transfers property to another and stipulates for payment by the purchaser to a third person, a suit by such person to enforce the stipulation will not
- F lie. In the present case, there is no sale for distribution of sale proceeds in terms of section 29(1). There is no realisation of the property, charged with debt, in terms of sub-sections (1) and (4) of section 29 of the Act. The interest of Central Bank of India and the mortgagor is totally defeated by the impugned arrangement between respondents no. 2 and 4. The words
- G “realisation of the property pledged, mortgaged, hypothecated” presupposes realisation of sale proceeds and application/appropriation thereof to liquidate the dues of the paramount charge-holder and from the surplus payment to person(s) entitled thereto. It is for this reason that the best possible price has got to be tried for under section 29 of the Act. In the circumstances,
- H we hold that the impugned agreement of sale as well as the transfer of assets

in favour of respondent no. 4 are in breach of section 29(1) and section 29(4) of the 1951 Act. A

In the present case, it has been urged that absence of valuation report and the reserve bid does not vitiate the sale. We do not find merit in this argument. In the case of *M/s S.J.S. Business Enterprises (P) Ltd.* (supra), B it has been held that the financial corporation, in the matter of sale under section 29, must act in accordance with the statute and must not act unreasonably. In this case, the corporation fails on both the counts. It has neither complied with the provisions of sub-sections (1) and (4) of section 29, nor has it acted fairly. The test of reasonableness has been laid down C in the above judgment in which it is held that reasonableness is to be tested against the dominant consideration to secure the best price. Value or price is fixed by the market. In the case of going concern, one has to value the assets shown in the balance sheet (*Valuation of Real Property by S. Datta page 198*). In our view, if the object of section 29 of the Act is to obtain D the best possible price then the corporation ought to have called for the valuation report. This has not been done. There is no inventory of assets produced before us. The mortgaged assets of the company could be sold on itemized basis or as a whole whichever is found on valuation to be more profitable. No particulars in that regard have been produced before us. If E publicity and maximum participation is to be attained then the bidders should know the details of the assets (or itemized value). In the absence of the proper mechanism the auction sale becomes only a pretence. Further, in this case, the corporation advanced Rs. 90 lacs to the company. At that time, it must have valued the assets. No such report has been produced. Lastly, in this case, the price of the assets is pegged to the dues of the F corporation and the Central Bank of India. The assets are agreed to be sold to respondent no. 4 not for the market price but against repayment of dues of the corporation plus a promise to discharge the liability of Central Bank of India. Therefore, the corporation, respondent no. 2, has not acted reasonably. It has not taken any steps to secure the best price. In fact it has failed to protect the interest of Central Bank of India, which is having G the second charge on the assets transferred to respondent no. 4 as well as the mortgagor which would be entitled to the balance of the sale proceeds, if any. It was contended that as the bids were withdrawn, the offer of respondent no. 4 was accepted. Even assuming for the sake of argument, that there were no offers except the offer of respondent no. 4, it shows that H

A value of the assets was Rs. 198.85 lacs [i.e. Rs. 28.85 lacs + Rs. 170 lacs). No reason has been given why respondent no. 2 did not insist of downright payment of Rs. 198.85 lacs.

B In addition to the vitiating circumstances enumerated above, we find that under the public notice dated 22.2.2002, tenders were invited. They were to be submitted by 21.3.2002. Under the said notice, the tenders were to be opened on 22.3.2002. The take over of assets is on 18.3.2002. However, on 19.3.2002, the corporation hands over the assets to respondent no. 4 against down payment of Rs. 28.85 lacs plus promise to the corporation that the purchaser undertakes to pay the dues of Central Bank of India. A part of the amount of Rs. 28.85 lacs was paid by demand drafts dated 9.3.2002. These circumstances indicate collusion between respondent no. 2 corporation, respondent 3 and respondent no. 4. The take over of assets is ordered on 18.3.2002 and on 19.3.2002, the assets are handed over to respondent no. 4 against down payment of Rs. 28.85 lacs in demand drafts dated 9.3.2002. Under section 29(1) of the Act, the corporation is entitled to sell or lease the assets in order to realise the pledged/hypothecated or mortgaged property. Under what colour of title were the assets handed over to respondent no. 4 on 19.3.2002? Was it under sale, lease or repayment of loan? There is no explanation as to how respondent no. 4 could have drawn demand drafts in favour of corporation on 9.3.2002 when their offer to purchase was on 17/19.3.2002. It is alleged on behalf of respondent no. 4 that they were given the assets with a specific understanding of return of property if a higher offer was received in the auction. No such understanding is recited in the minutes of the tender committee nor in the recitals in the impugned agreement dated 26.4.2002. We do not find any resolution/minutes of the Board of Directors of the corporation in that regard. In the agreement dated 26.4.2002, it has been recited that Rs. 90 lacs were advanced as loan in 1988 by corporation to the company against equitable mortgage of land and assets. Under section 69 of T.P. Act, equity of redemption existed in favour of the company. A mere agreement for sale of assets cannot extinguish the equity of redemption; it is only on execution of conveyance that the mortgagor's right of redemption will be extinguished. [See: *T.P. Act by Mulla* page 794]. In the present case, till today there is no conveyance and, therefore, on 21.3.2002 when appellant herein paid Rs. 28.85 lacs to the corporation representing H its full dues, there was complete liquidation of the dues of the corporation

and yet the corporation did not return the assets to the company and arbitrarily and for extraneous reasons adjusted the said amount to the account of M/s Aditya Flour Mills. The reason is obvious. The corporation intended to sell the assets only to respondent no. 4 for a paltry amount of Rs. 28.85 lacs. It has been repeatedly urged before us, on behalf of respondent no. 4, that the assets in question were not worth Rs. 10 crores as alleged by the appellant. Even if we assume that respondent no. 4 is right in its submission, even then, in terms of the offer of respondent no. 4, the property was worth Rs. 198 lacs. But the corporation handed over the assets and agreed to sell them against down payment of Rs. 28.85 lacs. No reason has been given by the corporation as to why it did not insist on the full payment of Rs. 198.85 lacs. Be that as it may, the appellant herein cleared the dues of the corporation on 21.3.2002, before opening of tenders on 22.3.2002, and yet the corporation did not return the assets to the company. Even the tender money deposited by the appellant was returned without any demand from the appellant so that it could be argued by the corporation that the appellant had withdrawn from the auction and therefore the offer of respondent no. 4 was accepted. In fact, the document at page 186 shows that appellant refused to collect the earnest money and, therefore, the amount was kept by the corporation in a separate account. Lastly, in the case of *Narandas Karsondas v. S. A. Kamtam & Anr.* reported in AIR (1977) SC 774, it has been held that putting of property to auction does not extinguish the right of redemption. Therefore, on 21.3.2002, the company had a right to redeem the assets. It was submitted that the appellant intended to buy the assets in his own name. We do not find merit in this argument. The record shows that the appellant as the director of the company offered to clear the dues of the corporation for which he insisted on the return of the title deeds (transfer papers) of M/s Katihar Flour Mills. In any event, in this case, we are concerned with the conduct of the corporation which was required to act in accordance with section 29 of the 1951 Act and not unreasonably. In this connection, it may further be pointed out that under the public notice inviting tenders, the corporation was obliged to call for matching offers from the directors/promoters/guarantors. The corporation did not call for such offers as its object was to keep out all counter-offers. Lastly, we are satisfied that the impugned agreement dated 26.4.2002 has been entered into without any consideration in favour of Central Bank of India. In conclusion, we may state that in the

A present case, respondent no. 2 corporation has misused its authority and power in breach of law by taking into account extraneous matters and by ignoring relevant matters which has rendered all its acts *ultra-vires*. [See: *Express Newspapers Pvt. Limited & Ors. v. Union of India & Ors.*, AIR (1986) SC 872 para 118].

B

In the circumstances, we set aside the impugned judgment and order of the High Court and grant to the appellant the reliefs claimed by him in the writ petition. We hereby set aside the agreement dated 26.4.2002 and we direct respondent no. 2 - corporation to transfer Rs. 28.85 lacs, wrongly appropriated to the account of M/s Aditya Flour Mills, to the account of

C

M/s Katihar Flour Mills (P) Ltd. Consequent upon such appropriation, the loan taken by the said company shall stand repaid. We further direct the concerned District Judge to restore possession of the assets (handed over by respondent no. 2-corporation to respondent no. 4-company on 19.3.2002) to M/s Katihar Flour Mills (P) Ltd. In this connection, the District Judge

D

is directed to draw-up an inventory of the assets. In case of shortfall, it would be open to M/s Katihar Flour Mills (P) Ltd. to take such steps as they may be advised. Consequent upon our setting-aside the agreement dated 26.4.2002, we direct the corporation to return the amount paid to it by respondent no. 4 on 19.3.2002.

E

Appeal is accordingly allowed, with no orders as to costs.

In the facts and circumstances of the case, no order is required to be passed in contempt petition No. 101 of 2003.

F

S.K.S.

Appeal allowed.