

## WHAT IS INSOLVENCY ?

According to popular usage an insolvent is one who is unable to pay his debts. But no man can be called "insolvent" unless a competent court declares him an insolvent. The statutes relating to insolvency lay down the procedure by which a person can be declared insolvent and the rules to be followed in distributing the properties of such a person among his creditors.

## INSOLVENCY LEGISLATION

The law relating to insolvency in India is contained in two statutes : The Presidency Towns Insolvency Act of 1909 and the Provincial Insolvency Act of 1920. The former applies to the presidency towns, *i.e.*, to Calcutta, Bombay and Madras. The latter applies to all areas other than the three towns mentioned above. The two Acts are based on the same principles.

*Differences.* Mulla<sup>1</sup> said that the differences between the two Acts relate mostly to matters of procedure. The points of differences are summed up below :

1. The procedure from the date of presentation of the petition to the date of adjudication.
2. The duties of the debtor, including his examination.
3. The person in whom the debtor's property is to be vested.
4. The doctrine of Relation Back.
5. The constitution of the courts.

*Bankrupt and Insolvent.* The Indian Acts relating to insolvency are based upon the English statutes on the subject. In English law the terms "bankrupt" and "bankruptcy" are used in the same sense as the terms insolvent and insolvency in India.

## THE OBJECT OF INSOLVENCY LEGISLATION

Insolvency legislation has a two-fold objective : (i) protection of debtors and (ii) safeguarding, as far as possible, the interests of creditors. These objects are sought to be achieved in the following way :

<sup>1</sup> Mulla, *Law of Insolvency*.

### **1. Distribution of insolvent's property**

After a person is declared insolvent by the court, his properties are taken over by an officer of the court (known as the Official Assignee or the Official Receiver). The properties are converted into cash and distributed among his creditors in proportion to the claim of each.

### **2. Cancellation of debts and removal of disqualifications**

After the distribution is complete, the unpaid debts (except certain specified debts) are cancelled and the insolvent is allowed to engage in trade or service without any of his former obligations. The creditors lose a part of their claims, the debtor gets a fresh start in life.

### **3. Benefits to creditors**

Insolvency legislation is also beneficial to the creditors. It ensures the equitable distribution of the debtor's remaining properties among all the creditors. If there were no insolvency laws the debtor would have been free to dispose of his properties in any way he liked. He might have wasted the properties or might have paid one creditor proportionately more than the other creditors. Because the court distributes the properties ratably each creditor is sure of getting at least something.

### **4. Fresh start in life by debtors**

Prior to the passing of insolvency legislation, a debtor who was unable to pay debts was regarded as a sort of criminal and was very often sent to jail. It was realised in course of time that inability to pay debts is more often due to misfortune than to misconduct and sending the debtor to jail is oppressive and unprofitable. Insolvency legislation provides a method by which the debtor can free himself from his past obligations and get a fresh start in life.

## **INSOLVENCY COURTS**

In the Presidency towns (i.e., in Calcutta, Madras and Bombay) Insolvency matters are dealt with by the High Courts. In other areas, such matters are dealt with by the District Courts. But courts subordinate to the district courts may deal with

insolvency matters if they are so empowered by the State Government concerned. Insolvency courts have power to decide all questions relating to the realisation and distribution of the debtor's properties and the determination of all questions relating to priority of claims as between different creditors.

### WHEN CAN A PERSON BE DECLARED INSOLVENT ?

Two conditions must be satisfied before a person can be adjudicated insolvent : (i) he must be a debtor, *i.e.*, he must owe money to others and his assets must be insufficient to meet all the claims upon them ; and (ii) the debtor has committed an 'act of insolvency'.

#### Act of Insolvency

An 'act of insolvency' is some act of the debtor which shows that he is financially embarrassed. Both the Presidency Towns Insolvency Act and the Provincial Insolvency Act contain a list of acts which are to be considered acts of insolvency when committed by a debtor. Only those acts which are listed as such by the statutes mentioned above are considered to be acts of insolvency.

#### Acts of Insolvency By An Agent

The principal can be adjudged insolvent for the act of an agent, provided the following conditions are fulfilled : (1) the act of the agent was expressly or impliedly authorised to do the act, or (2) if the nature of the principal's business is such that it may be considered the act of the principal.

#### List of Acts of Insolvency

Each of the following acts committed by the debtor is an act of insolvency :

1. If in India or elsewhere, he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally.

*Explanation* : The transfer of the bulk of a person's property for the benefit of creditors is clearly evidence of financial embarrassment and is therefore an act of insolvency. Any creditor, who is not a party to the transfer can apply for adjudication on this ground. The intention of the debtor does not matter because

the fact of transfer gives jurisdiction to the court. The transfer becomes void if the debtor is adjudged insolvent within three months of the transfer.

2. If in India or elsewhere, he makes a transfer of his property or any part thereof, with the intent to defraud or delay his creditors.

*Explanation* : In such cases it must be proved that the debtor had a dishonest intention—to defeat or delay creditors. Upon proof of such fact the court will issue an adjudication order. The transfer becomes void upon the passing of the order of adjudication.

3. If in India or elsewhere, he makes any transfer of his property or any part thereof it would under this (insolvency) or any other enactment for the time being in force, be void as a fraudulent preference if he were adjudged an insolvent. (See p. 463)

*Explanation* : Fraudulent preference occurs when an insolvent debtor prefers one creditor to another, *i.e.*, pays one creditor more than what he would have received had the properties been ratably distributed. Fraudulent preference amounts to an act of insolvency. Upon adjudication the creditor so preferred must refund the money obtained.

4. If, with intent to defeat or delay his creditors—

(i) he departs from or remains out of India ;

(ii) he departs from his dwelling house or usual place of business or otherwise absents himself ;

(iii) he secludes himself so as to deprive his creditors of the means of communicating with him.

*Explanation* : The intention of the debtor—to defeat or delay his creditors—can be gathered from the circumstances.

5. If any of his property has been sold or attached for a period of not less than 21 days in execution of the decree of any court for the payment of money.

*Explanation* : Under the Provincial Insolvency Act only a sale in execution is an act of insolvency, not attachment in execution.

6. If he petitions to be adjudged an insolvent.

7. If he gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debt.

8. If he is imprisoned in execution of the decree of any court for the payment of money.

9. If a creditor has served an "Insolvency Notice" in respect of any decree or order for payment of money (being a decree or order which has become final and the execution whereof has not been stayed), and if the debtor has not paid the money within the period specified in notice.

*Explanation* : Non-payment of money in terms of the notice amounts to an "act of insolvency". The rules regarding notice are stated below :

(a) The notice must be given according to the prescribed form and prescribed manner.

(b) It must specify the amount due. If the sum specified in the notice exceeds the actual amount, the insolvency notice does not become invalid, unless the debtor gives notice to the creditor in this regard.

(c) It must specify the period for its compliance, *i.e.*, not less than one month and in the case of a debtor residing outside India whether permanently or temporarily, such period as may be specified by the order of the Court granting leave for the service of such notice.

(d) It must specify the consequences of non-compliance.

The notice does not amount to an "act of insolvency" in the following cases :

(i) If the debtor makes an application against the notice and if it is allowed by the Court.

(ii) If the debtor resides, whether permanently or temporarily, outside India, unless the creditor obtains the leave of the Court.

(iii) If the debtor has a counter-claim, right of set-off or is entitled to have the decree or order set aside for the relief of indebtedness or made an application for the setting aside of the decree or order, or the time allowed for application has not expired or the decree or order is not executable under the existing law.

*Comment* : The provision of Insolvency Notice (stated in para 9) was enacted in Maharashtra in 1939. In 1978, it was applied to the whole of India under the Insolvency Laws (Amendment) Act 1978. This rule is under the Presidency Towns Insolvency Act, 1909 and also under the Provincial Insolvency Act, 1920.

## PROCEDURE OF ADJUDICATION

### Order of Adjudication

The order of court by which a person is declared to be insolvent is called the Order of Adjudication.

Before the court can pass an order of adjudication there must be a petition presented to it either by a creditor or by the debtor. The petitioning creditor or debtor must fulfil certain conditions.

### Conditions of a creditor's petition

The following conditions must be fulfilled before a creditor can present a petition for the adjudication of a person as insolvent :

1. The amount owned must be Rs. 500 or more. Two or more creditors may present a joint petition, in which case it is sufficient if the total claim of the creditors amounts to at least Rs. 500 in all.

2. The debt is a liquidated sum payable either immediately or at some certain future time.

3. The debtor must have committed an act insolvency within three months before the presentation of the petition.

4. A *secured creditor* i.e., one who holds some movable or immovable property of the debtor out of which he can realise his claims, is not ordinarily interested in insolvency proceedings because his dues are safe. But a secured creditor can present an insolvency petition if the following conditions are satisfied :

(i) he abandons his security in favour of all the creditors,  
or

(ii) the security is insufficient to meet his claims and the insufficiency amounts to at least Rs. 500. (In the latter case he must in his petition mention the valuation of the security and show that he satisfies the conditions mentioned above regarding a creditor's petition.)

### Conditions of debtor's petition

A debtor is entitled to present a petition for the adjudication of himself as an insolvent if *any one* of the following conditions are fulfilled :

(1) his debts amount to Rs. 500, or

(2) he has been arrested and imprisoned in execution of the decree of any court for the payment of money, or

(3) an order of attachment in execution of a money decree has been made and is subsisting against his property.

### **The Procedure of Insolvency**

Under both the Acts, insolvency is done through the following successive stages : (1) presentation of the insolvency petition and the evidence of it (2) the appointment of an interim Assignee or Receiver (3) passing the order of adjudication and (4) the discharge of the insolvent.

### **Procedure after the filing of an Insolvency petition**

A creditor's *petition* must be verified by an *affidavit* of the creditor or of some person having knowledge of the facts. At the hearing the court shall require proof of the debt of the petitioning creditor and of the debtor's act of insolvency. Notice of the petition must be given to the debtor. If all the necessary facts are proved the court will issue the order of adjudication. If the debtor appears and proves that he is not indebted or if he pays the amount due to the petitioning creditor no order of adjudication will be passed.

The court may at the time of presentation of the petition appoint an *interim receiver* to take charge of the properties of the debtor.

In the case of a debtor's petition, the debtor must prove that he is entitled to present the petition and upon such proof the court will issue an order of adjudication.

## **WHO CAN BE DECLARED INSOLVENT ?**

Any person, man or woman, who has attained majority can be declared insolvent if the conditions laid down in the Insolvency Acts are fulfilled. (See above under creditor's and debtor's petition.) Certain special cases are discussed below.

### **Minor**

In India a minor is not personally responsible for his debts and is not capable of entering into contracts. Therefore a minor cannot be adjudicated an insolvent. If by error a minor is adjudicated insolvent, the order must be annulled, *i.e.*, cancelled.

### **Lunatic**

A lunatic can be adjudged insolvent for debts incurred by him while he was sane. The other conditions necessary for

passing an Order of Adjudication must be satisfied, *e.g.*, there must be an act of insolvency. It must be noted that a lunatic cannot commit those acts of insolvency which involve conscious volition, *i.e.*, acts which involve intent. Thus a lunatic cannot stay away from his place of business "with intent to defeat and delay his creditors."

### **Women**

In India a married or an unmarried woman does not suffer from any contractual incapacity. She can own property and contract debts. Therefore she can be declared insolvent under appropriate circumstances.

### **Foreigner**

A foreigner can be adjudicated insolvent if he commits an act of insolvency in India while resident here.

### **Joint Debtors**

When money is borrowed by two or more persons jointly, all of them can be declared insolvent on a single petition provided some act of insolvency is committed by each of them or jointly by all.

### **Partners**

Since every partner is responsible for all the debts of the firm, the creditor of a firm can file an insolvency petition against any partner or all the partners for any debt due and owed by the firm. But it must be proved that the partner concerned has committed an act of insolvency. A minor partner cannot be declared insolvent for a partnership debt.

Under English law an adjudication order cannot be passed against a firm in the firm name. In India under both the Presidency Towns Insolvency Act and the Provincial Insolvency Act an adjudication order can be passed against a firm in the firm name. Such an order is equivalent to the adjudication of all the partners (except a minor partner, if any), as insolvent.

### **Joint Hindu Family**

A creditor of a joint Hindu Family can present a petition for the adjudication of all the members of the family as insolvent



provided the debt is one for which all the members are responsible and an act of insolvency has been committed by all the members jointly. Minor members will not be declared insolvent.

In the case of a joint Hindu family firm managed by the Karta, members who participate in the management and the Karta can be declared insolvent for debts due from the firm. If the management is solely in the hands of the Karta, only the Karta can be declared insolvent because the other members are not personally responsible for the debts—they are responsible only to the extent of their share in the joint family properties.

### Deceased Person

A dead man cannot be declared insolvent. His debts will be paid *pro rata* in course of the administration of his estate. If a debtor dies after the presentation of the insolvency petition, his estate will be administered by the Official Assignee as upon insolvency, unless the court otherwise directs.

### Legal Representative

The legal representative of a deceased debtor cannot be declared insolvent for a decree obtained against him as legal representative, because he is not personally responsible for such debts.

### Companies

A company cannot be declared insolvent. In case of insolvent companies the proper procedure is winding up.

### Convict

A prisoner in the jail can be declared insolvent.

## EXERCISES

1. What are the objects of insolvency law? How are they sought to be achieved? (Pages 452-453)
2. What are the main differences between Presidency Towns Insolvency Act and Provincial Insolvency Act? (Page 453)
3. Can the following persons be adjudicated as insolvent—a foreigner, a minor, a lunatic, one of the partners? (Pages 458-459)
4. State the stages of Insolvency *viz.*—(1) a person becomes insolvent, (2) the order of adjudication, (3) the administration of the insolvent properties and (4) the discharge. (Page 458)

5. When can a creditor file an application for the adjudication of his debtor as an insolvent? (Page 457)
6. When can a debtor file an application for his adjudication as an insolvent? (Page 457)
7. Define the following terms : (a) Act of insolvency (b) Order of Adjudication. (Pages 454, 457)
8. Objective questions. Give short answers.
  - (i) State whether a minor and a lunatic can be adjudged insolvent. (Page 458)
  - (ii) State whether a man with unsound mind can be adjudged an insolvent. (Page 458)
  - (iii) Who can be declared an insolvent? (Page 458)
9. State whether the following persons can be adjudged Insolvent.
  - (i) Deceased person,
  - (ii) Married women,
  - (iii) Legal Representative,
  - (iv) Minor. (Pages 458-460)

## LEGAL EFFECTS OF THE ORDER OF ADJUDICATION

The order of the court by which a person is declared insolvent is called the Order of Adjudication. Upon such an order being passed the following consequences ensue :

### 1. Vesting of the Properties of the insolvent

The properties of the debtor (except properties held by him in trust for others and tools of trade, wearing apparel and similar items) *vest in an officer of the court* who is called the Official Assignee (under the Presidency Towns Insolvency Act) and the Official Receiver (under the Provincial Insolvency Act).

All the properties of the debtor in India (except the items mentioned above) *automatically vest* in the Official Assignee or the Official Receiver and the insolvent no longer possesses any power to deal with such properties in any way. *Official Assignee of Bombay v. Registrar, Small Causes.*<sup>1</sup> As regards properties of the insolvent outside India, it has been held that movable properties vest in the same way as properties in India but immovable properties do not, unless the law of the country in which they are situated allows such vesting. *Yokohama Specie Bank v. Curlenders & Co.*<sup>2</sup>

### 2. Management

The Court may appoint a manager to assist the Official Assignee or the Official Receiver to manage the properties of the insolvent.

### 3. Administration

The Official Assignee or the Official Receiver takes possession of the properties, sells them and distributes the money among the creditors according to rules contained in the insolvency Acts.

### 4. Relation Back

The insolvency of a person commences, not from the date

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<sup>1</sup> 37-I.A 86

<sup>2</sup> 43 Cal L.J. 436

when the order of adjudication is passed, but from an earlier date. (See p. 469)

### **5. Suits against Insolvent**

After the Order of Adjudication is passed no creditor can commence any suit or legal proceedings against the insolvent except with the leave of the insolvency court and subject to such terms and conditions as the insolvency court may impose.

### **6. Stay of Suits**

A suit and proceeding already filed, may be stayed but may be continued with the leave of the insolvency court.

### **7. Proof of Debts**

After insolvency proceedings commence, all unsecured creditors have the right to prove their claims before the Official Assignee or the Official Receiver and thereafter get a share of the remaining assets of the insolvent. The position of secured creditors is different.

### **8. Personal Disqualifications**

Upon adjudication as an insolvent the debtor loses certain civic rights, *viz.*, he cannot hold the post of a magistrate, or any office under a local authority, or be a member of a local authority. These disqualifications are removed only if the order of adjudication is annulled (*i.e.*, cancelled), or if the insolvent is discharged with a certificate from the court stating that his insolvency was caused by misfortune and not by misconduct. In addition to the disqualifications laid down under the insolvency Acts, there are others imposed by different statutes. For example, under the Companies Act of 1956, an undischarged insolvent cannot act as director of a company.

### **9. Duties of the Insolvent**

The insolvent must produce his books of account to the Court, file a schedule of assets and liabilities and perform all the duties of the debtor, enumerated in the Insolvency Acts. (See p. 465)

### **10. Avoidance of Voluntary Transfers**

A voluntary transfer is a transfer without consideration *e.g.*, a gift. Under the Presidency Towns Insolvency Act all voluntary

transfers (except transfers made by the insolvent to his wife on the occasion of his marriage) become void and inoperative if an order of adjudication is passed against the transferor within two years of the date of transfer. Under the Provincial Insolvency Act all such transfers made within two years of the date of presentation of the petition for adjudication become void if an order of adjudication is passed on the petition. The properties involved in the transfer vest in the Official Assignee or the Official Receiver as the case may be.

### 11. Avoidance of Fraudulent Preferences

Fraudulent Preference means any act of the debtor by which one creditor is preferred to another in the matter of payment of his dues. Such preference can be shown by transfer of property, payment of money or otherwise. Suppose that a person is indebted to *X* for Rs. 5,000, to *Y* for Rs. 4,000 and *Z* for Rs. 2,000. His total assets amount to Rs. 3,000 and he transfers them to *Y* with the deliberate intention of giving an advantage to *Y* as against *X* and *Z*. This is fraudulent preference.

*Effects* : (i) A fraudulent preference is an act of insolvency. When a debtor does an act which amounts to a fraudulent preference any of his creditors can, within three months of the act, file a petition for declaring him insolvent.

(ii) The Insolvency Acts provide that a fraudulent preference is void and inoperative if the following conditions are satisfied :

- (a) the debtor was in insolvent circumstances at the time the transfer was made, *i.e.*, was unable to pay his debts as they fell due ;
- (b) the transfer was made in favour of a creditor and had the effect of preferring that creditor over others ;
- (c) the transfer was made by the debtor with a view to giving preference to that creditor ; and
- (d) the debtor was adjudicated insolvent on a petition presented within three months after the date of the transfer.

(iii) The money and property, received by the creditor who was fraudulently preferred, must be returned to the Official Assignee or Official Receiver if the debtor is adjudicated insolvent within three months of the date when the fraudulent preference occurred. But if the creditor had transferred any of

the properties received by him to a *bona fide* purchaser for value, the transfer is valid and the rights of the transferee are not affected.

## 12. The Protection Order

Protection Order means an order by the court prohibiting the arrest of an insolvent debtor in execution of a decree for the payment of money. Under the Presidency Towns Insolvency Act such an order may be passed after the order of adjudication is passed and after the insolvent has filed a schedule of his assets. But the court may, at its discretion, issue a protection order before the filing of the schedule, if necessary. Under the Provincial Insolvency Act a protection order may be passed any time after the admission of the petition for adjudication. If an insolvent is already under arrest the court may order his release.

## DUTIES OF THE DEBTOR

1. As soon as the petition for adjudication is admitted, the debtor must produce his books of account before the court.
2. Within 30 days of the date of the adjudication order (if the order is passed on the application of the debtor) and within 30 days of the service of the order of adjudication (if the order is passed on the application of a creditor) the insolvent must file a schedule of his assets and liabilities. The schedule must be verified by an affidavit and must contain an inventory of his properties and a list of his debts together with the names of the creditors. If without any reasonable excuse the insolvent fails to file a correct and proper schedule he may be committed to prison by the court.
3. **Public Examination of the Insolvent** : Under the Presidency Towns Insolvency Act the court fixes a date for holding a public examination of the insolvent. The insolvent must, on the appointed date, attend court and answer all questions put to him by the court, the Official Assignee and any creditor. The object of the examination is to determine the causes which led to insolvency. The court may dispense with the holding of the public examination if the insolvent is a lunatic or a *pardanashin* woman or if he or she is suffering from some disease or disablement.

Under the Provincial Insolvency Act the court must examine the debtor while the petition for adjudication is being heard, by the court. During such examination the creditors present may put questions to the debtor.

4. The insolvent must attend any meeting of the creditors which the Official Assignee may require him to attend and must disclose before the meeting such information as may be required.

5. The insolvent must execute such powers of attorney, transfers and instruments as may be required by the Official Assignee or the Official Receiver and must do all such acts and things in relation to his properties as may be required by the Official Assignee or the Receiver. Failure to perform any of these duties amount to contempt of court and the insolvent may be punished for it.

6. The insolvent must assist the Official Assignee, to the best of his ability, in the realisation of his property and the distribution of the property among the creditors.

7. **Private Examination :** The court may, on the application of the Official Assignee or the Official Receiver or any creditor who has proved his debt, summon before it the insolvent or any other person who is suspected or known to be in possession of property belonging to the debtor or is indebted to him or is capable of giving information regarding the insolvent's property or the causes of insolvency. When such persons attend, questions are asked by the court.

If the person summoned does not attend he may be arrested upon a warrant issued by the court.

If the person summoned admits that he is indebted to the insolvent, the court may issue an order for the payment of the money to the Official Assignee. Similar orders may be issued as regards any property of the insolvent held by the person examined. The orders of the court regarding payment of money or the delivery of property can be executed like decree of a court.

### **PROPERTY OF THE INSOLVENT**

The term property has been defined in the Insolvency Act so as to include properties of which the insolvent is the owner and also properties over which he has a disposing power. Some of these properties are available for distribution among the creditors, some are not.

### Properties available for distribution among creditors

The following types of properties can be distributed among the creditors :

1. All properties, movable or immovable, of which the insolvent was the owner at the *date of commencement of insolvency* (except trust properties, tools of trade and certain other items). The following types of properties are available for distribution among creditors : immovable properties ; cash in hand, jewellery and other movables ; life insurance policies ; patents and copyrights belonging to the insolvent ; partnership assets, including goodwill in case of insolvency of a firm ; leasehold interests ; occupancy rights ; actionable claims etc.

2. Properties which may be acquired by the insolvent or which may devolve upon him *after* the commencement of insolvency but *before* the date of discharge *e.g.*, a legacy. As regards properties coming within this category it has been held in several cases under the Presidency Towns Insolvency Act, that they do not vest automatically in the Official Assignee. The Official Assignee must intervene and claim the property. These decisions are based on the rule laid down in the English case, *Cohen v. Mitchell*.<sup>1</sup> Under the Provincial Insolvency Act, however, such properties vest automatically in the Official Receiver.

Salary earned by the insolvent after the commencement of insolvency must be handed over to the Official Assignee or Receiver except such portion of it as may be allowed to the insolvent for his maintenance.

3. If the insolvent has any power of disposal over some other person's property, which he can use for his own benefit, such power vests in the Official Assignee *Example* : The power of the father in a Mitakshara joint family to dispose of the undivided interest of the son.

4. Goods of which the insolvent is the reputed owner vest in the Official Assignee. (See pages 372-373)

### Property not divisible among creditors

Properties of the following types can be retained by the insolvent. They are not available for distribution among the creditors :

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<sup>1</sup> (1890) 25 Q.B.D 262



1. Properties held by the insolvent in trust or on behalf of other persons.

2. Under the Presidency Towns Insolvency Act, the insolvent can retain his tools of trade, wearing apparel and cooking utensils. The total value of all these things must not exceed Rs. 300.

3. Under the Provincial Insolvency Act, the insolvent is allowed to retain all those properties which are exempted from attachment and sale execution of a decree, according to provisions of the Civil Procedure Code. Such properties include wearing apparel, cooking utensils, tools of trade and certain other items.

4. The right to sue a third party for personal injuries does not vest in the Official Assignee or the Receiver. Similarly a *spes successionalis*, i.e., a mere chance of getting some property upon the death of another does not pass upon insolvency.

5. Moneys in a recognised provident fund, gratuities and pensions (subject to certain limits) are not available for distribution among creditors.

### **\* THE DOCTRINE OF REPUTED OWNERSHIP**

Goods left with the insolvent by others can be taken possession of by the Official Assignee or Receiver on behalf of the creditors under the circumstances mentioned below. This is known as the Doctrine of Reputed Ownership.

1. They must be movable goods.
2. They must be in the possession of the insolvent.
3. There must be no mark or other indication showing that the goods belong to some person other than the insolvent.
4. The circumstances are such that people dealing with the insolvent are likely to believe that the goods belong to the insolvent.

The sale proceeds of such goods are available for distribution among the creditors of the insolvent. The true owner of the goods can claim as a creditor of the insolvent for the value of the goods. His position is that of an unsecured creditor.

The Doctrine of Reputed Ownership does not apply in the following cases : (i) Immovable properties. (ii) Goods taken on hire-purchase. (iii) Goods which were in the possession of the

insolvent as repairer or carrier or commission agent or as pawnee.  
(iv) Goods in the possession of the insolvent as trustee or administrator or executor or any similar capacity.

### THE DOCTRINE OF RELATION BACK

The insolvency of a person commences, not from the date when the order of adjudication is passed, but from an earlier date. The order of adjudication relates back and operates from an earlier date. This is known as the Doctrine of Relation Back.

Under the Presidency Towns Insolvency Act the insolvency of a debtor commences from the date when the first act of insolvency was committed by the debtor within three months before the date of presentation of the insolvency petition.

Under the Provincial Insolvency Act, the insolvency of the debtor commences from the date of presentation of the petition on which the order of adjudication was passed.

#### *Example :*

The insolvent performed the Act of Insolvency on 1st April. The petition for Order of Adjudication was filed on 29th June. The Order of Adjudication was issued on 1st August.

Under the Presidency Towns Insolvency Act, the insolvency of the debtor commences on 1st April. Under the Provincial Insolvency Act, the insolvency commences from 29th June.

### PROTECTED ANTECEDENT TRANSACTIONS

The term Protected Transaction is used to denote the transactions of the insolvent, in relation to his property, which are not invalidated by the insolvency proceedings. Such transactions can be classified as follows :

1. *Transactions entered into before the commencement of the insolvency proceedings* : All such transactions are good except, (i) transfers of property made without consideration within two years before the commencement of insolvency. Such transfers are called Voluntary Transfers and they can be set aside by the Official Assignee or the Receiver. But a voluntary transfer to the wife of the insolvent on the occasion of his marriage is not deemed to be a voluntary transaction and is protected. (ii) A transfer of property to a creditor under circumstances which amount to a fraudulent preference is not protected. Such a transfer can be avoided by the Official Assignee or the Receiver.

2. *Transactions entered into between the date of the filing of the insolvency petition and the Order of Adjudication* : Any such transaction is protected if (i) it is not a voluntary transfer or a transaction amounting to fraudulent preference, and (ii) the other party to the transaction had no knowledge of the presentation of the insolvency petition.

3. *Transactions entered into after the Order of Adjudication* : Such transactions are not protected. They are invalid and can be set aside by the Official Assignee or the Official Receiver.

### POSITION OF SECURED CREDITORS

A secured creditor is one who has lent money to the insolvent on the security of some movable or immovable property. A secured creditor has the right to realise his dues in full out of the security given to him and this right is not affected by the insolvency proceedings. It is therefore said that secured creditor stands outside the insolvency. But he can participate in the insolvency proceedings if he so desires. When a debtor is declared insolvent, secured creditor has the following options before him.

1. He can have the security sold. If the sale proceeds are greater than his dues, he must refund the excess to the Official Assignee or Receiver. If the sale proceeds are less than his dues, he can prove for the balance before the Official Assignee or Receiver. For this balance his position is like that of an unsecured creditor and he will get payment at the same rate as other creditors do.

2. He can surrender his security to the Official Assignee or Receiver and prove for his whole claim like an unsecured creditor. He will receive payment at the same rate as other unsecured creditors.

3. He can value his security and submit to the Official Assignee a claim for the balance, if any, together with a statement of the particulars of the security and the assessed value. In this case the Official Assignee can redeem the security by paying the assessed value.

### POWERS OF OFFICIAL ASSIGNEE/RECEIVER

The Presidency Towns Insolvency Act provides that it is the duty of the Official Assignee to realise the properties of the

insolvent and distribute the same among the creditors with all convenient speed. For this purpose he can exercise the following powers *without leave of court* :

(a) He can sell all or any part of the property of the insolvent.

(b) He can give receipts for any money received by him.

The Official Assignee can, *with the leave of the Court*, do all or any of the following things :

(1) carry on the business of the insolvent so far as may be necessary for the beneficial winding up of the same ;

(2) institute, defend or continue any suit or other legal proceedings relating to the property of the insolvent ;

(3) employ a legal practitioner or other agent to take any proceedings or do any business which may be sanctioned by the Court ;

(4) accept as the consideration for the sale of any property of the insolvent a sum of money payable at a future time or fully paid shares, debentures or debenture stock in any limited company subject to such stipulations as to security and otherwise as the Court thinks fit :

(5) mortgage or pledge any part of the property of the insolvent for the purpose of raising money for the payment of his debts or for the purpose of carrying on the business :

(6) refer any dispute to arbitration, and compromise all debts, claims and liabilities, on such terms as may be agreed upon ;

(7) divide in its existing form amongst the creditors, according to its estimated value, and property which, from its peculiar nature or other special circumstances, cannot readily or advantageously be sold.

*Duties* : The Official Assignee shall account to the Court and pay over all moneys and deal with all securities in such manner as is prescribed or as the Court directs.

The powers and duties of the Official Receiver under the Provincial Insolvency Act are similar to those given to the Official Assignee.

### **Disclaimer of Onerous Property**

“Onerous Property” means property which is subject to an obligation or liability. *Examples* : land the ownership of which is subject to restrictive covenants or obliges the owner to some personal service ; shares on which there are unpaid calls :

property which is not readily salable. Unprofitable contracts, entered into by the insolvent, also come within the category.

Under the Presidency Towns Insolvency Act, the Official Assignee is given power to disclaim such property, *i.e.*, refuse to accept it. Such disclaimer must be made by notice in writing signed by the Official Assignee within 12 months of the date of the Order of Adjudication or within 12 months of the date on which the Official Assignee came to know the existence of such property.

Disclaimer of onerous property is essential to prevent the Official Assignee from being burdened with the obligations connected with the onerous property. Whenever the liabilities relating to a property are larger than its value, disclaimer is made.

Upon disclaimer the rights, interests and obligations of the insolvent relating to the disclaimed property come to an end. A person who is affected by the exercise of the right of disclaimer is treated as a creditor of the insolvent to the extent of the damage suffered by him and can prove for the same as a debt under insolvency.

The Official Assignee cannot disclaim a leasehold interest without the leave of the Court.

### **DUTIES OF THE OFFICIAL ASSIGNEE/RECEIVER**

1. The Official Assignee or the Official Receiver must realise the property of the insolvent with all convenient speed.

2. Money received by him must be kept and accounted for according to the rules made by the court.

3. He must distribute the moneys received by him among the creditors without showing any partiality to any particular creditor.

4. He must pay due regard to the wishes of the creditors as indicated in meetings of creditors and must submit schemes of arrangement and composition, if any, before the creditors.

5. He must obey orders of the Court.

### **MEETING OF CREDITORS**

The Presidency Towns Insolvency Act provides that the Court may, any time after passing the Order of Adjudication, and upon the application of the Official Assignee or any creditor,

direct that a meeting of the creditors be convened for the purpose of considering the causes and circumstances that led to the insolvency, the insolvent's schedule and the mode of dealing with the insolvent's estate. Subject to the provisions of the Act and the directions of the Court, the Official Assignee must have regard to the wishes of the creditors as expressed in the resolutions passed in the creditor's meetings.

### THE COMMITTEE OF INSPECTION

It is provided by both the Insolvency Acts that the Court may authorise the creditors who have proved their debts to appoint from among themselves a committee to be known as the Committee of Inspection. The duties of the Committee of Inspection are as follows :

- (1) to convey to the Official Assignee or Receiver the wishes of the creditors ; and
- (2) to keep watch over the administration of the estate of the insolvent.

Details regarding the powers of the Committee of Inspection are prescribed in the insolvency rules framed by the High Court.

### “COMPOSITION” AND “SCHEMES OF ARRANGEMENT”

After insolvency proceedings commence, the debtor can come to an understanding with the creditors regarding the payment of the debts. Such understanding or settlement may be of two types : (i) it may be a “composition” of the debts or (ii) it may be a “scheme of arrangement”. When the debtor pays immediately, or by agreed instalments, some money to the creditors less than what is due to them and the latter agree to accept such lesser amount in full satisfaction of their claims, there is said to be a composition of the debts. On the other hand when the debtor and the creditors agree to a scheme by which the debts are gradually liquidated (perhaps without selling all the debtor's assets) there is said to be a “scheme of arrangement”.

A proposal for composition or arrangement must be submitted to the Official Assignee or Receiver after the Order of Adjudication is passed. The Official Assignee or Receiver must thereupon submit the proposal before a meeting of the creditors. If in such creditors' meeting a majority in number and three-

fourths in value of the creditors who have proved their claims, agree to accept the proposal it is put up before the Court for approval. Before giving approval the Court shall consider the conduct of the insolvent and the objections of dissentient creditors, if any. If after hearing the Official Assignee and the creditors, the Court is of opinion that the proposal is reasonable and beneficial to the general body of creditors, it will give its sanction. The Court will not sanction any composition or scheme of arrangement in the following cases :

1. If it considers the proposal to be unreasonable and not beneficial to the creditors.

2. In cases coming under the Presidency Towns Insolvency Act, if the circumstances are such that the Court must refuse, suspend or attach conditions to the debtor's discharge, the Court will not sanction a scheme of arrangement or composition unless it provides reasonable security for the payment of at least four annas in the rupee on all unsecured debts proved against the insolvent.

3. In cases coming under the Provincial Insolvency Act under circumstances similar to those mentioned above, the Court will not sanction any composition or scheme of arrangement unless there is reasonable security for the payment of at least six annas in the rupee.

### **Comments**

When the Court sanctions a composition or scheme of arrangement, its terms shall be recorded in the order of the Court, the insolvency proceedings shall be terminated and the Order of Adjudication shall be annulled.

If the insolvent defaults in carrying out the terms of the composition or arrangement, or if the Court is of opinion that it cannot be carried on without unnecessary delay, or if the Court finds that the approval of the Court was obtained by fraud, the composition or scheme of arrangement will be annulled and the debtor will be readjudged insolvent.

### **PROOF OF DEBTS**

The following debts can be proved in insolvency proceedings :

1. Debts incurred by the insolvent for a fixed or ascertained sum of money.

2. Claims for which a decree has been passed by a court of law.
3. Unascertained claims for damages arising from breach of contract or breach of trust.

The following debts cannot be proved in insolvency proceedings :

1. Unascertained claims, except those arising from breach of contract or breach of trust.
2. Debts the value of which cannot be estimated and debts which are illegal, immoral or against public policy.
3. Under the Presidency Towns Insolvency Act, debts contracted from a person who has knowledge of the presentation of the insolvency petition cannot be proved.

### Mode of Proof of Debts

Debts are provable according to the method laid down by the rules of the High Court concerned. Under the Presidency Towns Insolvency Act the usual procedure is that the creditor has to send a registered letter to the Official Assignee with an affidavit containing particulars of the claim. The Official Assignee may ask for the production of vouchers or other evidence of the claim. Under the Provincial Insolvency Act the claim has to be submitted to the Court.

### DISTRIBUTION OF INSOLVENT'S PROPERTY

Out of the assets realised by the sale of the insolvent's properties, the Official Assignee or Receiver must retain such sums as are necessary for meeting the costs, charges and expenses of administering the estate of the insolvent. The balance is to be distributed among the creditors in the following order :

1. Payment must be made *first* to meet the following claims—
  1. Debts due to the Government or any local authority.
  2. Wages of any clerk, servant or labour employed by the insolvent for services rendered during four months previous to the presentation of the insolvency petition, subject to the following limits : (i) under the Presidency Towns Insolvency Act—Rs. 300 for a clerk and Rs. 100 for each servant or labour (ii) under the Provincial Insolvency Act.—Rs. 20 for each.
3. Under the Presidency Towns Insolvency Act arrears of rent of the landlord for one month.



4. Arrears of compensation payable to a workman under the Workmen's Compensation Act.

The debts mentioned above rank equally and must be paid in full before any payment can be made for other debts. If the assets are not sufficient, to pay all these debts in full, they abate in the same proportion (*i.e.* they are reduced in equal proportion).

II. If any assets are left after paying the preferential claims mentioned above, the balance is distributed among the unsecured creditors ratably. In case of insufficiency all claims abate proportionately.

### **Interest**

No interest runs after the Order of Adjudication is passed. Creditors can claim interest on their debts up to the date of the order of adjudication to the extent interest is allowable under the law for the debt in question.

If, however, it is found that the assets are sufficient to pay all creditors in full and a surplus exists in the hands of the Official Assignee or Receiver, interest will be paid to the creditors for the period after the Order of Adjudication at the rate of 6% per annum.

### **Mutual Dealing and Set-off**

When there are mutual dealings between the insolvent and a creditor, an account is taken and the creditor is allowed to claim for the balance due, if any. In such accounting the sums paid by one party to the other are set off against sums received by him. But if a creditor who has given credit to the insolvent did so with the knowledge of the presentation of an insolvency petition, he cannot claim the benefit of any set-off.

### **Dividends**

The Official Assignee or Receiver is required to complete the distribution of the insolvent's property with all convenient speed. The insolvency rules therefore provide that some amount shall be distributed within one year of the adjudication order unless the Court is satisfied that there is good reason for postponing payment. The first instalment of payment is called the first dividend. Subsequent dividends are required to be declared and distributed at intervals of six months until the whole

estate is administered. The amount of each dividend depends on the amount collected and the amounts which the Official Assignee or Receiver must keep in his hands for disputed claims and his costs, charges and expenses.

### ANNULMENT OF THE ORDER OF ADJUDICATION

The Order of Adjudication will be annulled, *i.e.*, cancelled in the following cases :

1. Where the Order of Adjudication was wrongly passed *e.g.*, when it is found that the person adjudicated is a minor or lunatic or otherwise outside the jurisdiction of the court, or where it is found that the order was passed on the petition of a person who was not entitled to present the petition.

2. Where it is proved to the satisfaction of the Court that the debts have been paid in full.

3. Where it is found that the same person has been adjudicated insolvent by more than one court, the insolvency proceedings will continue in one court only and the orders of the other courts must be annulled.

4. When a composition or scheme of arrangement is sanctioned by the court, the Order of Adjudication must be annulled.

5. The adjudication may be annulled if the insolvent does not appear on the date fixed for the hearing of his application for his discharge or does not apply for discharge within the period specified by the Court.

*Effects* : The effects of annulment vary according to the circumstances under which the annulment is made. But all acts done by the Official Assignee or the Receiver prior to the annulment remain good. After the Order of Adjudication is annulled the properties of the insolvent remaining undisposed of, again vest in him and all processes and remedial measures in force against him on the date of the adjudication order again revive.

### SMALL INSOLVENCIES

The Insolvency Acts provide for a summary procedure when the estate of the insolvent is small. Under the Presidency Towns Insolvency Act an insolvency is considered small when the value of the insolvent's estate is not likely to exceed Rs. 3,000 and under the Provincial Insolvency Act, Rs. 500. In case of small

insolvencies the insolvency rules are modified in the manner stated below.

*Under the Presidency Towns Insolvency Act :*

- (a) no appeal shall lie from any order of the Court, except by leave of the Court ;
- (b) no examination of the insolvent shall be held except on the application of a creditor or the official assignee ;
- (c) the estate shall, where practicable, be distributed in a single dividend ;
- (d) such other modification as may be prescribed with the view of saving expense and simplifying procedure.

*Comments :* There can be no modification of the provisions of the Act relating to the discharge of the insolvent.

The Court may at any time, if it thinks fit, revoke an order for the summary administration of an insolvent's estate.

*Under the Provincial Insolvency Act :*

- (a) unless the Court otherwise directs, no notice required under this Act shall be published in the Official Gazette ;
- (b) on the admission of a petition by a debtor, the property of the debtor shall vest in the Court as receiver ;
- (c) at the hearing of the petition, the Court shall enquire into the debts and assets of the debtor and determine the same, by order in writing, and it shall not be necessary to frame a schedule under the provisions of Section 33 ;
- (d) the property of the debtor shall be realised with all reasonable despatch and thereafter, when practicable, distributed in a single dividend ;
- (e) the debtor shall apply for his discharge within six months from the date of adjudication ; and
- (f) such other modifications as may be prescribed with the view of saving expense and simplifying procedure.

Provided that the Court may at any time direct that the ordinary procedure provided for in this Act shall be followed in regard to the debtor's estate and thereafter the Act shall have effect accordingly.

## EXERCISES

1. What are the consequences of the Order of Adjudication '86, '89 ?  
(Pages 462-464)
2. Enumerate the different types of debts which are entitled to priority is the distribution of the property of an insolvent.  
(Pages 465-468)
3. Explain briefly the doctrine of Reputed Ownership, Relation Back and Fraudulent Preference as under the Insolvency Law.  
(Pages 468, 463-464)
4. At what point of time does the insolvency of a debtor commence ? What is the effect of insolvency on property which the insolvent gets after the adjudication order ?  
(Pages 468-470)
5. State the duties of an insolvent after adjudication. When can the Court annul an order of adjudication ? What are the effects of such an annulment ?  
(Pages 465-466, 477)
6. What is a "Protection Order" in insolvency ? Who passes it ? When and what is the effect of such an order ?  
(Pages 465)
7. State the different types of properties which vest in the Official Receiver or the Official Assignee on the adjudication of the debtor.  
(Pages 466-468)
8. What are the disqualifications of a debtor when he is adjudged as insolvent ? How can these disqualifications be removed ?  
(Page 463)
9. Discuss the circumstances under which the order of adjudication can be annulled.  
(Page 477)
10. Write notes on : Official Assignee ; Official Receiver ; Protection Order ; Public Examination ; Private Examination ; Secured Creditor ; Committee of Inspection ; Annulment ; Small Insolvencies. (Pages 462 ; 462 ; 465 ; 470 ; 473 ; 477 ; 477)
11. Objective Question :  
(a) What is the doctrine of reputed ownership ? (Page 468)

**The Order of Discharge**

The Order of Discharge is an order of the court by which the insolvent is released from the burden of his pre-existing debts (except certain special types of debts) and is relieved of the personal disqualifications which follow from insolvency. From the date of the order of Adjudication to the date from which the Order of Discharge operates, the debtor is an "undischarged insolvent". After the Order of Discharge, the term "insolvent" can no longer be applied to him.

**Application and Date**

Both the insolvency Acts provide that the insolvent can apply for discharge any time after the passing of the Order or Adjudication. Under the Presidency Towns Insolvency Act this application will not be heard until after the public examination of the insolvent, unless such public examination has been dispensed with. Under the Provincial Insolvency Act the Court is required to fix a date within which the insolvent must apply for discharge.

**Powers of the Court**

When the application for discharge has been received the Court fixes a date for hearing it. Before passing any order the Court must hear the report of the Official Assignee of the Receiver regarding the conduct of the insolvent and his dealings with his properties. The Court also hears the representations of the creditors if any. After hearing all these parties the Court may,

- (1) grant an absolute order of discharge ;
- (2) refuse to pass any order of discharge ;
- (3) pass an order of discharge but suspend the operation of the order for a specified period ; or
- (4) grant an order of discharge subject to any conditions with respect to any earnings or income which may afterwards become due to the insolvent, or with respect to his after-acquired property.

### Refusal or circumstances under which the Court must refuse an order of discharge

Under the Presidency Towns Insolvency Act, the Court must refuse to pass the order of discharge if the insolvent has committed an offence punishable under the Insolvency Act or under Sections 421 to 424 of the Indian Penal Code. The offences punishable under the Insolvency Act are : fraudulent concealment of the insolvent's state of affairs by destruction of documents ; keeping false books ; failure to attend public examination without sufficient reasons, etc. The offences punishable under the Indian Penal Code are fraudulent removal, concealment, or disposal of property to prevent its distribution among his creditors ; fraudulently preventing debts from being realised by creditors ; false and fraudulent recitals regarding consideration or interest of the transferee in documents by which property is transferred by the insolvent.

### Refusal of discharge or Conditional discharge

It is provided by the Presidency Towns Insolvency Act that under the circumstances mentioned below, the court can either *refuse discharge* or issue a *conditional order of discharge* :

1. The insolvent's assets are not of a value equal to four annas in the rupee on the amount of his unsecured liabilities, unless he satisfies the court that the *insufficiency of assets* has arisen from circumstances for which he cannot be held responsible. (Under the Provincial Insolvency Act the insolvent's assets must amount to at least eight annas in the rupee.)

2. The insolvent has *omitted to keep such books* of account as are usual and proper in the business carried on by him and as sufficiently disclose his business transactions and financial position within the three years immediately proceeding his insolvency.

3. The insolvent has *continued to trade* after knowing himself to be insolvent.

4. The insolvent has contracted any debt provable under the Act without having at the time of contracting it *any reasonable or probable ground* of expectation (the burden of proving which lies on him) that he will be able to pay it.

5. The insolvent has failed to account satisfactorily for any loss of assets or any *deficiency of assets* to meet his liabilities.

6. The insolvent has brought on or contributed to his insolvency by rash or hazardous speculations or by unjustifiable *extravagance* in living, or by *gambling*, or by culpable neglect of his business affairs.

7. The insolvent has put any of his creditors to unnecessary expense by a *frivolous or vexatious* defence to any suit properly brought against him.

8. The insolvent has, within three months preceding the time of presentation of the petition, incurred *unjustifiable expense* by bringing a frivolous or vexatious suit.

9. The insolvent has within three months preceding the date of the presentation of the petition; when unable to pay his debts as they become due, given an *undue preference* to any of his creditors.

10. The insolvent has concealed or removed his books or his property or any part, thereof has been guilty of any other fraud or fraudulent breach of trust.

11. When the insolvent has *already been adjudged* insolvent on a previous occasion or has made *compositon or arrangement* with his creditors.

*Comments* : The power of suspending and of attaching conditions to an insolvent's discharge may be exercised concurrently.

On any application for discharge, the report of the Official Assignee shall be *prima facie* evidence and the Court may presume the correctness of any statement contained therein.

The provisions of the Provincial Insolvency Act are more or less similar to those mentioned above.

### **Conditions that might be imposed**

When a conditional order of discharge is issued, the Court can impose any one or more of the following conditions :

1. Payment by the insolvent to the official Assignee or the Receiver of the whole or any part of his future earnings or after-acquired property.

2. Keep the order of discharge suspended until a dividend of at least four annas in the rupee has been paid to the creditors.

3. Require the insolvent to consent to a decree being passed in favour of the Official Assignee for any unsatisfied balance or part thereof of his debts provable in insolvency, to be executed later on.

## EFFECTS OF THE ORDER OF DISCHARGE

Subject to certain exceptions, an absolute order of discharge (i) releases the insolvent from all debts which were provable in insolvency and (ii) removes the personal disqualifications from which an undischarged insolvent suffers, e.g., inability to hold certain posts. The exceptions are stated below :

1. The Order of Discharges does not release the insolvent from the following debts—

- (a) A debt due to the Government (e.g., unpaid taxes or money due for purchasing goods from a Government-owned establishment).
- (b) Any debt or liability incurred by means of fraud or fraudulent breach of trust (e.g., a promoter's liability for making secret profits is not terminated by his insolvency).
- (c) Any debt or liability in respect of which the insolvent has obtained forbearance by means of fraud.
- (d) Any order for maintenance in favour of the wife or children of the insolvent issued under the Criminal Procedure Code.

Debts and liabilities of the aforesaid type continue after the order of discharge. The insolvent is bound to meet these obligations from his after-acquired property or earnings.

2. Debts incurred by the insolvent after the order of adjudication but before discharge remain binding upon him, because such debts are not provable in insolvency.

3. An order of discharge does not release any person who, at the date of the presentation of the petition, was a partner or co-trustee with the insolvent or was jointly bound or had jointly made a contract with him, or any person who was a surety, or in the nature of a surety, for him.

4. The insolvent is not exempted from punishment for violations of the penal provisions of the Insolvency Acts merely because of the fact that he has obtained his discharge (or that a composition or scheme of arrangement regarding his affairs has been sanctioned by the Court).

5. The order of discharge does not really terminate the insolvency proceedings. The Court retains power to direct the distribution of the properties remaining in the hands of the Official Assignee or Receiver and in case there was an error in



their distribution the Court has power to direct a redistribution. A creditor who failed to prove his claim before discharge can prove his claim after discharge provided there are assets in the hands of the Official Assignee or the Receiver and provided he can be paid without disturbing the previous distribution.

### EXERCISES

1. What is meant by "discharge" of an insolvent? State the exact effects of an order of discharge. (Pages 480, 483-484)
2. Explain what is meant by discharge of an insolvent. What are the grounds on which absolute discharge may not be granted? (Pages 480-481)
3. Under what circumstances is an insolvent discharged? What is the effect of such discharge? What debts, if any, continue after discharge? (Pages 480, 481-484)
4. State the cases in which a court (*a*) is bound to refuse an absolute discharge to an insolvent; (*b*) may refuse an order of discharge to an insolvent. (Pages 480-481)

# BOOK VIII

## **ARBITRATION**

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<b>CHAPTER 1</b>	<b>General Provisions</b>	<b>486 – 491</b>
	What is Arbitration ? 486 ; The Arbitration Agreement 486 ; Effects of an Arbitration Agreement 487 ; Who can refer disputes to Arbitration ? 488 ; Matters which can be referred to Arbitration 489 ; Different Types or Methods of Arbitration 489 ; Statutory Arbitration 490 ; Foreign Awards 491.	
<b>CHAPTER 2</b>	<b>Arbitration Without The Intervention of The Court</b>	<b>492 – 504</b>
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### WHAT IS ARBITRATION ?

Arbitration means the settlement of a dispute by referring the dispute to a third party and abiding by his decision. Arbitration is less costly than a suit in a court of law. It is also more expeditious. Therefore, commercial contracts frequently contain a clause providing for a reference to arbitration in case a dispute breaks out concerning any matter relating to the contract. The policy of the legislature in India has always been to encourage settlement of disputes by arbitration. Also, in India, reference of disputes to the *Panch* or the *Panchayet* is a traditional and widely used method of settling disputes.

The law relating to arbitration in India is contained in the Arbitration Act of 1940.

### THE ARBITRATION AGREEMENT

#### Definition

An arbitration agreement means "a written agreement to submit present or future differences to arbitration, whether an arbitrator is named therein or not".—Sec.2(a).

The arbitration agreement or the arbitration clause in an agreement is sometimes called "Submission". This latter term was used in the acts relating to arbitration in India prior to the Act of 1940. In the corresponding English Act the term "Submission" is used.

#### Essentials

1. An arbitration agreement, to be valid and binding, must be *in writing*. Such an agreement must satisfy all the *essential elements of a valid contract*.

2. Signatures of the parties are not necessary but it must be shown that they agreed to the *settlement of disputes* by arbitration. It is not necessary that the agreement should be contained in a formal document. The record of such an agreement in *a clause* in the contract or in *a letter or memorandum* is enough.

3. It is not necessary that the name of the person who will act as the arbitrator should be mentioned in the agreement.

4. The agreement may be to refer *present differences* or possible *future differences* to arbitration.

5. When there is an arbitration clause in a contract and the contract comes to an end owing to frustration (see p. 123) or is avoided on the ground of fraud or misrepresentation, the arbitration clause may continue to be binding. *State of Bombay v. Adamjee*.<sup>1</sup> But if the parties were not *ad idem*, i.e., if there was no contract at all, the arbitration clause is not binding. *Tolaram v. Birla Jute Manufacturing Co.*<sup>2</sup>

6. The agreement to refer disputes to arbitration is not valid if it lacks the essential elements of a contract, e.g., if it was brought about by fraud or coercion.

7. The construction of an arbitration agreement is not to be thwarted by narrow pedantic interpretation. *Union of India v. M/S D. N. Revri & Co. and others*.<sup>3</sup>

## EFFECTS OF AN ARBITRATION AGREEMENT

### Bar of Suits

When some persons have entered into an agreement to refer disputes relating to a matter to arbitration they may be prevented from agitating the same matter in a court of law. Thus an arbitration agreement is a *bar to a civil suit* relating to matters covered by the arbitration agreement. If any of the parties to the agreement disregards the agreement and files a suit, the other party to the agreement may file an application for staying the suit.

Section 34 of the Act empowers the court to stay the suit if the following conditions are satisfied :

1. The suit or proceedings relate to the same matter as that covered by the arbitration agreement. No stay will be granted if the suit relates to matters outside the scope of the arbitration agreement. If the suit relates partially to matters included in the agreement, the court may stay the suit or not according to its discretion.

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<sup>1</sup> AIR (1951) Cal. 147

<sup>2</sup> (1948) 2 Cal. 171

<sup>3</sup> AIR (1976) Supreme Court 2257

2. It must be shown that the party desiring stay was and is ready and willing to proceed with the arbitration and does everything necessary for the purpose.

3. The party desiring stay must not have filed his written statement (*i.e.* his defence to the suit) or taken any step in connection with the defence against the suit (*e.g.* an application for extension of time to file the written statement).

4. The arbitration agreement must not have been the result of fraud and there must not exist any other sufficient reason why the dispute should not be decided by arbitration.

*The grant of stay is discretionary.* But unless there is a strong reason to the contrary the court will, by staying the suit, force the parties to abide by the arbitration agreement. The burden of proof is upon the party opposing stay to convince the court that there are reasons for continuing the suit or proceedings and not granting the stay. *Anderson Wright Ltd. v. Morgan & Co.*<sup>1</sup>

### WHO CAN REFER DISPUTES TO ARBITRATION ?

The arbitration agreement is a contract. Therefore, only those persons, who are capable of entering into contracts, can refer disputes to arbitration.

The persons who can refer to arbitration are enumerated below :

1. A *minor* or a *lunatic* cannot refer disputes to arbitration but the guardian of a minor or of a lunatic can do so on his behalf.

2. In a suit or proceeding, the *next friend* or *guardian ad litem* cannot enter into any compromise on behalf of a minor without the leave of the court.

3. A *partner* can refer disputes relating to the firm to arbitration provided such power is given to him by the partnership agreement.

4. An *agent* cannot refer disputes to arbitration unless especially authorised.

5. The *manager* of a joint Hindu family can submit arbitration for the petition of the joint family property.

6. A *trustee* may refer disputes of arbitration.

7. *Solicitors* and *advocates* have no implied authority to submit arbitration on behalf of the clients.

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<sup>1</sup> (1955) S.C.A. 165 (Supreme Court)

8. An *insolvent* cannot submit to arbitration but the Official Receiver or Assignee may submit with the leave of the court.

### MATTERS WHICH CAN BE REFERRED TO ARBITRATION

Subject to the exceptions noted below, all disputes which can be decided by a civil suit can also be decided by arbitration. *Examples* : Disputes about property or money ; amounts of damages payable for breach of contract ; maintenance payable to wife ; terms of separation between husband and wife ; question of law ; etc.

Matters of personal right (*e.g.*, the right to hold the office of *Pujari* in temple) and disputes regarding compliment or dignity, which cannot be decided by civil courts, can nevertheless be decided by arbitration.

The following matters cannot be referred to arbitration :

1. Matrimonial matters like divorce or restitution of conjugal rights.
2. Testamentary matters like the validity of a will.
3. Insolvency matters *e.g.*, the adjudication of a person as insolvent.
4. Matters relating to the guardianship of a minor or of a lunatic or declaring a person insane.
5. Criminal matters. Whether a person is guilty of an offence or not, cannot be decided by arbitration.
6. Questions relating to charities or charitable trust cannot be referred to arbitration except with the consent of the Advocate-General in Presidency Towns and of the Collector of the place in other areas.

### DIFFERENT TYPES OR METHODS OF ARBITRATION

The Arbitration Act includes within its scope three types or methods of arbitration :

#### I. Arbitration without the intervention of the court

Sections 3 to 25 of the Act relate to this type of arbitration. In this case the arbitration proceedings take place outside the court. There is no suit pending but the award of the arbitrator can be filed in court and executed through the court as if it was a decree of the court (Rules discussed in ch. 2).

## II. Arbitration through court when no suit is pending

Where there is an arbitration agreement, the parties may proceed with the arbitration independently of any court, in the manner described in the 2nd chapter. Section 20 of the Act, however, lays down an alternative procedure which the parties may follow.

Where there is an arbitration agreement, but no suit is pending, any of the parties may apply to the court for filing the *arbitration agreement*. The court thereupon issues notice to the other parties requiring them to show cause why the agreement should not be filed. Where no sufficient cause is shown the court shall order the agreement to be filed and shall make an order of reference to the arbitrators appointed in the manner laid down in the agreement, or where the parties cannot agree upon an arbitrator, to an arbitrator appointed by the court. Thereafter the arbitration proceeds in the same manner as outlined in ch. 2.

## III. Arbitration a Suits

After a suit is filed, the parties may decide to settle the matter by arbitration. The procedure for doing so is laid down in Sections 21 to 25.

Where in any suit all the parties interested agree that any matter in difference between them in the suit shall be referred to arbitration, they may at any time before judgment is pronounced apply in writing to the court for an order of reference.

The arbitrator shall be appointed in such manner as the parties agree. (The parties may make the judge the arbitrator, in which case his judgment becomes an award and is not appealable). There may be a reference of a part of the matter in issue in the suit, provided such part can be dealt with separately.

After an order of reference is made, the arbitration takes place in the same manner as an arbitration without the intervention of court.

## STATUTORY ARBITRATION

Some statutes provide for compulsory arbitration in disputes arising out of matters covered by them, e.g., the Co-operative Societies Act, 1912 ; The Industrial Relations Act, Maharashtra.

This is called Statutory Arbitration. The Statute concerned generally provides for the procedure according to which the compulsory arbitration will be conducted. If it does not, or if a question of procedure arises which is not covered by its provisions, the rules laid down in the Arbitration Act will apply [except Sections 6(1), 7, 12, 36 and 37].—Sec. 46.

### FOREIGN AWARDS

The Arbitration (Protocol and Convention) Act, 1937 and the Foreign Awards (Recognition and Enforcement) Act, 1961, provides that an award made in a foreign country will be enforceable in India, in the same manner as an award made in India, provided the following conditions are fulfilled.

1. The award relates to a matter considered as commercial under the law in force in India.

2. The award is made in a country with which India has a reciprocal agreement for the enforcement of awards and is one in which one of the parties is subject to the jurisdiction of a power with which there is such reciprocal arrangement.

3. The award is final, *i.e.*, on proceedings are pending in the foreign country concerned for contesting the validity of the award.

The Act mentioned above was passed as a result of an international agreement for the enforcement of foreign awards. India was a signatory to the Protocol drawn in an international conference on the subject.

### EXERCISES

1. State the essentials of an arbitration agreement. (Pages 486-487)
2. Explain a "submission to arbitration". What matters may be referred to arbitration? (Pages 486, 489-490)
3. What is meant by an arbitration agreement and what is its effect? (Pages 486-487)
4. What matters cannot be referred to arbitration? (Pages 489-490)
5. State the modes or types of submission to arbitration. (Pages 489-490)



## **2** ARBITRATION WITHOUT THE INTERVENTION OF THE COURT

### **PROVISIONS IMPLIED IN AN ARBITRATION AGREEMENT**

Section 3 and the First Schedule to the Arbitration Act provides that an arbitration agreement, unless a different intention is expressed therein, shall be deemed to include the following terms :

1. Unless otherwise expressly provided, the reference shall be to a sole arbitrator.

2. If the reference is to an even number of arbitrators, the arbitrators shall appoint an umpire not later than one month from the latest date of their respective appointment.

3. The arbitrators shall make their award within four months after entering on the reference or after having been called upon to act by notice in writing by any party to the arbitration agreement or within such extended time as the court may allow.

4. If the arbitrators do not make an award within the time mentioned above or if they notify any of the parties or the umpire that they cannot agree, the umpire must forthwith enter on the reference in lieu of the arbitrators.

5. The umpire shall make his award within two months of entering on the reference or such extended time as the court may allow.

6. The parties to the reference and all persons claiming under them must, if so required by the arbitrators or the umpire, submit to be examined by them upon oath or affirmation and must produce before them all necessary books, papers and documents and do all other things which, during the reference, the arbitrators or umpire may require.

7. The award shall be final and binding on the parties and persons claiming under them respectively.

8. *Costs* : The costs of the reference and award shall be in the discretion of the arbitrators or umpire who may direct to and by whom, and in what manner, such costs or any part thereof shall be paid. The arbitrators or the umpire may tax or settle the amount of costs to be paid or any part thereof and may award costs to be paid as between legal practitioner and client.

## THE APPOINTMENT OF ARBITRATORS

The general rule is that the parties to the dispute select the arbitrator or arbitrators by mutual consent. They can select any person or body of persons, whatever his or their qualifications may be. Sometimes it is arranged that each party to the dispute shall nominate one or more arbitrators and all such persons shall jointly act as arbitrators.

The parties to an arbitration agreement may agree that any reference thereunder shall be to an arbitrator or arbitrators to be appointed by a person designated in the agreement either by name or as the holder for the time being of any office or appointment—Sec. 4. Thus the parties may agree that the arbitrator shall be appointed by the Bengal Chamber of Commerce or by the *Sirpanch* of a village.

It is an implied term of the arbitration agreement that if there is an even number of arbitrators and they do not agree on the award, they shall appoint another person to decide the matter. Such a person is called the Umpire. The Umpire's decision is final.

When there are more than two arbitrators, the decision of the majority is final, unless a contrary intention appears from the agreement. If they are equally divided, they must appoint an umpire.

*Three arbitrators* : Section 10 of the Act provides that where the agreement provides for a reference to three arbitrators, one to be appointed by each party and the third by the arbitrators, the agreement shall have effect as if it provided for the appointment of an umpire by the two arbitrators and not a third arbitrator.

### Disqualifications of arbitrators

A person cannot act as an arbitrator if he had an interest in the subject matter or if he is a necessary witness of the disputed matter.

### Power of a party to appoint a new arbitrator or a sole arbitrator

Section 9 of the Act lays down that where an arbitration agreement provides that a reference shall be to two arbitrators, one to be appointed by each party, the following rules shall apply :

(1) If either of the appointed arbitrators neglects or refuses to work, or is incapable of acting, or dies, the party who appointed him may appoint a new arbitrator in his place.

(2) If one party fails to appoint an arbitrator, either originally or by way of substitution as aforesaid, for 15 clear days after the service by the other party of a notice in writing to make the appointment (such other party having already appointed his arbitrator) the other party may appoint his arbitrator to act as the sole arbitrator in the reference, and his award shall be binding on both parties.

But the court may set aside any appointment as sole arbitrator under rule (2) above and may, on sufficient cause shown, allow further time to the defaulting party to appoint an arbitrator or pass such other order as it thinks fit.

### **Power of the Court to appoint arbitrator or umpire**

The need for appointing an arbitrator or umpire by the court may arise in the following cases : (Sec. 8)

(a) Where the agreement provides that the arbitrator or arbitrators shall be appointed by consent of all the parties and all parties do not concur in the appointments.

(b) If any appointed arbitrator or umpire neglects or refuses to work, or is incapable of acting, or dies, and the arbitration agreement does not show that it was intended that the vacancy should not be supplied, and the parties or the arbitrators as the case may be, do not supply the vacancy.

(c) Where the parties or the arbitrators are required to appoint an umpire and do not appoint him.

### **Case Law :**

The court has no power to supply a vacancy under Section 8 (1) (b) only if the arbitration agreement shows that the parties did not intend to supply the vacancy. If no such intention could be culled out from the arbitration clause, the court could supply the vacancy. When there was a named Arbitrator, even though he was named by office, it was open to the court to supply the vacancy in his place under Section 8 (1) (b). *Union of India v. M/S Raghunath Singh and Co.*<sup>1</sup>

*Procedure* : Section 8 of the Act provides that under any of the aforesaid circumstances any party may serve the other

<sup>1</sup> AIR (1980) Supreme Court 103

parties or the arbitrators, as the case may be, with a written notice to concur in the appointment or appointments or in supplying the vacancy.

If the appointment is not made within 15 clear days after the service of the said notice, the court may on the application of the party who gave the notice and after hearing the other parties appoint the arbitrator or arbitrators or umpire as the case may be. The person or persons appointed by the court shall have power to act in the reference in the same manner as if appointed by the consent of all parties.

Section 12 (1) of the Act provides that where the court removes an umpire or one or more of the arbitrators for misconduct or any other reason, it can appoint persons to fill up the vacancy.

### REVOCAION OF THE ARBITRATOR'S AUTHORITY

After the umpire and arbitrators are properly appointed, their authority can be revoked (*i.e.* cancelled) only under the following circumstances :

1. The arbitration agreement may provide for the revocation of the authority of the umpire or arbitrators. In this case, any of the parties may submit an application to the Court for leave for revocation. The application must be made before the award is complete. The Court should give notice to the arbitrator. The Court's decision depends on the facts and circumstances of the case.

2. The court can, under Section 5 of the Act, grant leave for such revocation. The court generally does it only if a just and sufficient cause is shown. *Example* : (a) Arbitrator not acting according to the rules of natural justice (b) arbitrator acting in collusion with a party (c) partiality or bias (d) frustration (e) unreasonable delay (f) excess or refusal of jurisdiction by the arbitrator, etc.

### Effects of death of a party

The authority of an arbitrator is not revoked by the death of the party who appointed him. The death of a party does not discharge the arbitration agreement. In such cases the award is enforceable against the legal representatives of the deceased.—

Sec.6.

### Effect of Insolvency

An arbitration clause in a contract entered into by a person who subsequently becomes insolvent, is binding on the Official Assignee or Receiver unless the contract is disclaimed as onerous property. If the contract is accepted, the arbitration clause must be accepted. The Official Assignee or Receiver can also enforce the arbitration clause—Sec. 7.

### REMOVAL OF ARBITRATOR OR UMPIRE

The court may on the application of a party, remove an arbitrator or umpire in the following cases :

1. *Delay* : If the arbitrator or umpire fails to use all reasonable despatch in entering on and proceeding with the reference and making an award.

2. *Misconduct* : If the arbitrator or umpire has misconducted himself or the proceedings.—Sec. 11.

[For the meaning of Misconduct—See p. 503]

When an arbitrator or umpire is removed according to the above rules, he is not entitled to any remuneration.

*New appointment* : When the court removes an umpire who has not entered into the reference, or one or more arbitrators (but not all the arbitrators) the court can appoint persons to fill the vacancy.

Where the authority of an arbitrator or arbitrators or of the umpire is revoked with leave of the court or where the court removes an umpire who entered into the reference or a sole arbitrator or all the arbitrators, the court may on the application of any party—

(a) appoint a person to act as the sole arbitrator in place of the persons removed, or

(b) order that the arbitration agreement shall cease to have effect with respect to the difference referred.—Sec. 12.

### DUTIES OF THE ARBITRATOR AND THE UMPIRE

1. *Reasonable despatch* : The arbitrator and the umpire must, with all reasonable despatch enter into the reference and make an award.

2. *Quasi-judicial position* : The arbitrator and the umpire hold a quasi-judicial position. They must decide the dispute

impartially. An arbitrator is not the agent of the party appointing him. After the appointment is made he must not secretly communicate with him and must not accept any gift or payment from him. He must act judicially.

3. *Rules of natural justice* : The arbitrator or umpire is not required to follow the procedure of civil courts but they must observe the rules of natural justice (for example, both parties must be given a hearing in all matters).

4. *Misconduct* : The arbitrator and the umpire must not misconduct themselves in any way (e.g., accept bribes).

5. *Within the arbitration agreement* : The arbitrator and the umpire must act within the scope of the arbitration agreements. They should sign and file the award within due time.

### Duties of an umpire

The duties of the umpire are the same as those of an arbitrator. But he may commence the proceedings anew. He may not decide the award on the basis of evidence already given.

## POWERS OF ARBITRATOR AND UMPIRE

Section 13 of the Act lays down that the arbitrator or umpire shall (unless a contrary intention is expressed in the agreement) have the following powers :

(1) to administer oath to the parties and witnesses appearing :

(2) to state a special case for the opinion of the court on any question of law involved or state the award, wholly or in part, in the form of a special case of such question for the opinion of the court ;

(3) make the award conditional or in the alternative ;

(4) correct in an award any clerical mistake or error arising from any accidental slip or omission ;

(5) administer any party to the arbitration such interrogatories (questions in writing) as may, in the opinion of the arbitrators or umpire, be necessary.

The following powers are usually given to the arbitrator in the arbitration agreement :

(6) He may decide by and to whom the cost of the reference is to be met.

(7) He may award interest.

(8) When an award of money is given, the arbitrator can fix the instalment thereof and their amount and time.

(9) Under certain circumstances the arbitrator can order the specific performance of the terms of the contract.

(10) He may make interim awards to be followed by a final award.

#### Case Law :

(i) Where there is arbitration through the intervention of the Court, the arbitrator cannot enlarge the scope of the reference and entertain fresh claims without a further order of reference from the Court. *Orissa Mining Corporation Ltd. v. M/S Prannath Vishwanath Rawlley.*<sup>1</sup>

(ii) Under Section 13 of this Act the arbitrator can grant future interest on the amount awarded up to the date of realisation. *State of Punjab v. Ajit Singh and others.*<sup>2</sup>

### THE ARBITRATOR'S REMUNERATION

The arbitrator's remuneration is determined by agreement between the parties and the arbitrator before arbitration proceedings commence. If there is no such agreement the arbitrator can fix his own remuneration. But if an unreasonably high charge is made, any of the parties can apply to the court under Section 38 of the Act whereupon the court determines what is reasonable remuneration for its arbitrator.

### AWARD

#### ★ Definition

The "Award" means the decision of the arbitrator or the umpire.

#### Essentials

1. *Writing* : The award must be in writing in such form and in such language as the umpire and the arbitrators may think fit.

2. *Date and Signature* : The award must be signed and dated.

3. *Notice* : The arbitrators shall give notice in writing of making the award to all the parties.

4. *Fees and Charges* : The arbitrators shall state the amount of fees and charges payable in respect of the arbitration and the award.

<sup>1</sup> AIR (1977) Supreme Court 2014

<sup>2</sup> AIR (1979) Full Bench, P & H 179

5. *Legality* : The award must be in conformity with the submission. It must be certain and final and give a decision on all matters referred. It must not say anything outside the reference.

### Procedure

At the request of any party (after the cost and charges have been paid) or if the court so directs, the arbitrator or umpire shall file the award or a signed copy of it in court together with all depositions and documents which have been taken and proved before them. After they are filed the court gives notice to the parties.—Sec. 14.

Where the court sees no cause to remit, modify or set aside the award, it shall pass judgment in terms of the award and a decree shall follow. Such a decree is not appealable, except in so far as it is in excess of or not in accordance with the award.—Sec. 17.

### Legal Decisions :

1. Arbitrator's award on both fact and law is final and there is no appeal from his verdict. The court cannot review his award and correct any mistake in his adjudication unless objection to the legality of award is apparent on face of it. *Firm Madanlal Roshanlal Mahajan v. Hukumchand Mills Ltd., Indore.*<sup>1</sup>
2. If the award is silent on a particular item of dispute, the claim in respect thereof should be taken as rejected by the arbitrator. *Santa Sila Devi v. Dharendra Nath Sen.*<sup>2</sup>

### “The award is an instrument of offence and defence”

The award of arbitrators and the umpire amounts to a final judgment as regards the matters referred to them. There can be no appeal against an award. An award can be modified, remitted or set aside only in certain cases provided in the Act. Apart from these cases, an award is final.

Any of the parties to the arbitration proceedings can have the award, executed as a decree of the court. The award can therefore be called an instrument of offence.

Any matter decided by the award of arbitrators or an umpire validly made, cannot be reopened by a suit. If a suit is filed on such a matter, it will be dismissed. The award therefore is an instrument of defence.

<sup>1</sup> AIR (1967) Supreme Court 1031    <sup>2</sup> AIR (1963) Supreme Court 1677



## POWERS OF THE COURT

The Act gives various powers to the court in relation to arbitration proceedings. A list of these powers is given below. The circumstances under which these powers are exercisable are laid down in the Act.

1. The court can give leave to a party to revoke the authority of the arbitrator appointed by him.—Sec.5.

2. The court can appoint an arbitrator or umpire.—Sec.8.

3. The court can remove arbitrators or the umpire and appoint other persons in their place or appoint some persons as the sole arbitrator.—Secs. 11 and 12.

4. The court can modify an award.—Sec.15.

5. The court can remit an award for reconsideration.—Sec.16.

6. The court can pass judgment in term of the award and thereupon a decree is issued which is capable of execution.—Sec.17.

7. The court can pass interim orders, wherever necessary (e.g. appoint receivers and issue injunction).—Sections 18, 41 and the Second Schedule.

8. The court can supersede the arbitration agreement.—Sec. 19. Where an award has become void or has been set aside, the court may by order supersede the reference and shall thereupon order that the arbitration agreement shall cease to have effect with respect to the difference referred.

9. The Court may order the arbitration agreement to be filed in the court on the application of the parties or any of them.—Sec. 20.

10. The Court may by order refer to arbitration, any pending suit at the request of the parties.—Secs. 21 and 23.

11. The court can enlarge the time for making an award.—Sec.28.

12. When the award is for money, the court can in its decree order the payment of interest (at such rate as the court may consider reasonable) from the date of the decree.

13. The court can set aside an award.—Sec. 30.

14. The court can stay any suit or legal proceeding relating to a matter which is covered by a valid arbitration.—Sec. 34.

15. The court can decide disputes as to arbitrator's remuneration and costs.—Sec. 38.

16. The court can issue processes for the appearance of witnesses before arbitrators.—Sec. 43.

17. The court can appoint receiver or any other official for the detention, preservation or inspection of any property or thing which is the subject of the reference.—Schedule II, Arbitration Act.

### WHEN AN AWARD CAN BE MODIFIED OR CORRECTED

The court can, by order, modify or correct an award in the following cases.—Sec. 15 :

(a) Where the award has left undetermined any of the matters not referred to arbitration and such part can be separated from the other part and does not affect the decision on the matter referred ; or

(b) where the award is imperfect in form, or contains any obvious error which can be amended without affecting such decision ; or

(c) where the award contains a clerical mistake or an error arising from an accidental slip or omission.

*Correction By The Arbitrator or Umpire* : After an award has been filed the umpire and arbitrators cease their function. They may, however, correct or modify an award in the following cases :

1. When there is a clerical mistake in the award.—Sec. 13(d).
2. When an award is remitted to them.—Sec. 16.

### WHEN AN AWARD CAN BE REMITTED FOR RECONSIDERATION

The court may from time to time remit the award or any matter referred to arbitration to the same arbitrators or umpire for reconsideration upon such terms as it thinks fit, in the following cases.—Sec. 16 :

(a) Where the award has left undetermined any of the matters referred to arbitration, or where it determines any matter not referred to arbitration and such matter cannot be separated without affecting the determination of the matters referred ; or

(b) where the award is so indefinite as to be incapable of execution ; or

(c) where an objection to the legality of the award is apparent on the face of it.

Where an award is remitted for reconsideration, the court shall fix a time within which the arbitrators and umpire shall file the fresh award. Such time may be extended. If no award is filed within the time allowed, the original award becomes void.

### Legal Decision

The Courts have decided that the following grounds are good for remitting an award :

- (a) where there was misconduct of the arbitrators or umpire.
- (b) where new evidence has been found, and
- (c) where the arbitrator admits his mistake and he asks that the award should be remitted.

### WHEN THE COURT CAN SET ASIDE AN AWARD

Section 30 of the Act provides that the court can set aside an award only in the following cases :

1. If an award is made after the issue of an order by the court superseding the arbitration or after arbitration proceedings have become invalid under Section 35.

The court can supersede arbitration proceedings when an award becomes void or has been set aside. Arbitration proceedings become invalid when a suit or legal proceedings have been commenced relating to the subject-matter of the reference, notice of the same has been given to the arbitrator or umpire and none of the parties have asked for stay of the suit or legal proceedings. An award made under the aforesaid circumstances can be set aside by the court.

2. When an award has been improperly procured or is otherwise invalid. An award may become "otherwise invalid" for a variety of reasons. Some examples are given below : when the existence of the arbitration agreement cannot be proved ; when the consent of a party to an arbitration agreement has been procured by fraud ; when the arbitrators or the umpire has been appointed in improper manner ; etc. *Chhogal Ratwatmal v. Sankal Chad Shah & others*.<sup>1</sup>

3. **Error of Law** : The umpire as sole arbitrator is not bound to give a reasoned award and if in passing the award he makes a mistake of law or of fact, there is no ground for challenging the validity of the award. It is only when an erroneous proposition of law is stated in the award and which is the basis of the award,

<sup>1</sup> 53 C.W.N. 828

can the award be set aside or remitted on the ground of error of law apparent on the face of the record. *Champasen Bhara & Co. v. Jivraj Ballooc Co. Ltd.*<sup>1</sup> *Union of India v. Bungo Steel Furniture (P) Ltd.*<sup>2</sup>

4. Where an arbitrator or umpire has misconducted himself or the proceedings.

### MISCONDUCT

Misconduct means improper conduct. The term covers moral turpitude and also failure on the part of the umpire or arbitrator to act according to the duties and responsibilities of his office. Any action or behaviour on the part of the arbitrator or umpire which shows the existence of partiality or a lack of judicial spirit amounts to misconduct. If the arbitrator or umpire is guilty of misconduct, the court will set aside the award. *Amir Begam v. Badruddin.*<sup>3</sup>

The following acts have been held to be misconduct under this section : bribery ; undue partiality in favour of one party ; arbitrator secretly acquiring an interest in the subject-matter of the arbitration ; wrongfully refusing to hear a witness or a party ; etc. *Mosely v. Simpson.*<sup>4</sup>

5. *Moral lapse* : "Misconduct under Section 30(a) has not a connotation of moral lapse. It comprises legal misconduct which is complete if the Arbitrator on the face of the award arrives at an inconsistent conclusion even on his own finding or arrives at a decision by ignoring very material documents which throw abundant light on the controversy to help a just and fair decision." *K. P. Poulose v. State of Kerala and another.*<sup>5</sup>

6. The arbitrator or umpire must conform to any directions contained in the agreement of reference.

The arbitration agreement lays down a particular method by which the disputes are to be decided. In this case, the arbitrators have not complied with that method. Held, the arbitrators have misconducted themselves and the award has to be set aside. *Ramnath Agarwalla v. M/S Goenka & Co.*<sup>6</sup>

Arbitrator awarding damages without specifying the rate. Held, no misconduct. *State of West Bengal v. L. M. Das.*<sup>7</sup>

<sup>1</sup> AIR (1923) Privy Council 66    <sup>2</sup> AIR (1967) Supreme Court 1032

<sup>3</sup> 36 All 336 Privy Council    <sup>4</sup> (1873) L.R. 16 Eq. 226

<sup>5</sup> AIR (1975) Supreme Court 1259    <sup>6</sup> (1973) 77 C.W.N. 317 (Full Bench)

<sup>7</sup> AIR (1976) Cal 406

### Procedure

To set aside an award there must be an application to the court under Section 30 or by a notice of motion.

### APPEALS

An appeal shall lie from the following orders passed under this Act (and from no others) to the Court authorised by law to hear appeals from original decrees of the Court passing the order : An order—(i) superseding an arbitration ; (ii) on an award stated in the form of a special case ; (iii) modifying and correcting an award ; (iv) filing or refusing to file an arbitration agreement ; (v) staying or refusing to stay legal proceedings where there is arbitration agreement ; (vi) setting aside or refusing to set aside an award ; provided that the provisions of this Section shall not apply to any order passed by a Small Causes Court.—Sec. 39(1).

No second appeal shall lie from an order passed in appeal under this Section but nothing in this Section shall affect or take away any right to appeal to the Supreme Court.—Sec. 39 (2).

### EXERCISES

1. What is Arbitration and how is it effected ? Briefly state the powers of the court in respect of awards. (Pages 486-487, 500)
2. What are the provisions implied in an arbitration agreement without the intervention of the court ? (Page 492)
3. Define "Legal misconduct" by an arbitrator. What are the consequences of misconduct ? (Page 503)
4. Examine the circumstances when the court may modify or correct an award. (Page 501)
5. What are the grounds for setting aside an award under the Arbitration Act ? (Pages 502-503)
6. State under what circumstances the Court can remove an arbitrator validly appointed by the parties. (Page 496)
7. When the Court may appoint an Arbitrator or Arbitrators or an Umpire ? (Page 494)
8. When can a party to an arbitration agreement appoint a new arbitrator or a sole arbitrator ? (Pages 493-494)
9. Write note on power of arbitrator. (Page 497)
10. If one of three arbitrator dies, what action may be taken for filling the vacancy ? (Page 494)
11. When can the Court remit an award to the arbitrators or umpire for re-consideration ? (Pages 501-502)

**BOOK IX**  
**SECURITIES**

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**Securities**

**506 – 514**

Mortgage 506 ; Classification of Mortgages 507 ; Rights and Liabilities of Partners 509 ; Charge 511 ; Mortgage and Pledge 512 ; Hypothecation 512 ; Lien 513.

## MORTGAGE

### Definition

When a specific immovable property is made the security for the payment of money or the performance of an obligation, the transaction is called a Mortgage.

Section 58(a) of the Transfer of Property Act defines mortgage as, "transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an engagement which may give rise to a pecuniary liability."

The person transferring the interest (the debtor) is called the *mortgagor*. The person to whom the interest is transferred (the creditor) is called the *Mortgagee*. The amount secured is called the *Mortgage Money*. The document in which the transaction is recorded and by which the transfer of interest is made is called *Mortgage Deed*.

### Characteristics

The characteristics of a mortgage are described below :

1. In a mortgage there is a transfer of an interest in some specific immovable property.
2. The interest is transferred by way of security.
3. The security is for the due repayment of a loan or a debt, incurred or to be incurred for any purpose, or the performance of an engagement which may create a pecuniary liability.
4. If the money due or the pecuniary liability is not met within the agreed time, the interest transferred (*i.e.*, the security) can be sold through the court and the dues recovered.
5. A valid mortgage can be effected only by a written document, signed by the mortgagor and two attesting witnesses, and registered. To this rule there are two exception : (i) In Calcutta, Bombay, Madras and certain other towns a mortgage can be made by handing over the title deeds of the property concerned, without any written and registered document (this is

known as Equitable Mortgage). (ii) If the sum secured is less than Rs. 100, mortgage can be made by delivery of possession of the property.

6. A mortgage is a contract. Therefore it must satisfy all the essential elements of a contract, e.g., capacity of parties, free consent etc.

## CLASSIFICATION OF MORTGAGES

The terms and conditions incorporated in a mortgage deed may differ in different cases and accordingly there are different types of mortgage. The Transfer of Property Act classifies mortgages into the following six types :

### 1. Simple Mortgage

A simple mortgage has the following characteristics :

- (i) The mortgagor retains possession of the property.
- (ii) The mortgagee is given the right, in case of non-payment of the mortgage-money, to have the property sold through the court and realise his dues from the sale proceeds.
- (iii) The mortgagor undertakes that if the sale proceeds of the property are insufficient to repay the money due, the mortgagor will remain personally liable for the payment of the debt.

### 2. Mortgage by way of Conditional Sale

In this case the mortgage transaction is entered into in the form of a sale. The characteristics are as follows :

- (i) The mortgagor ostensibly sells the property to the mortgagee.
- (ii) The mortgagee undertakes that if the mortgage-money is repaid on a certain date he will resell the property to the mortgagor or that the sale shall be void.
- (iii) The mortgagor agrees that if the mortgage-money is not repaid on the fixed date, the sale shall be absolute.
- (iv) The conditions regarding resale etc. are incorporated in the mortgage deed.

### 3. English Mortgage

An English mortgage is very similar to a mortgage by the conditional sale. The characteristics are as follows :



- (i) The mortgagor sells the property *absolutely* to the mortgagee.
- (ii) The mortgagee agrees to reconvey the property to the mortgagor if the mortgage-money is paid up by a certain date.

An English mortgage differs from a mortgage by conditional sale in two respects, viz., (a) in the former there is an undertaking by the mortgagor to repay the debt ; in the latter there is none ; (b) in the latter, the mortgagee cannot sue for the mortgage-money or for the sale of the property ; in the former he can.

#### 4. Usufructuary Mortgage

The characteristics of an usufructuary mortgage are as follows :

- (i) The mortgagor delivers possession of the property to the mortgagee.
- (ii) The mortgagee takes the rents and profits of the property and appropriates the same to the interest and the principal sum due.
- (iii) When the full amount due has been recovered in the manner aforesaid, the mortgagee gives up possession of the property to the mortgagor.
- (iv) The mortgagee cannot sue for the mortgage-money or for the sale of the property ; his only remedy is to continue in possession till he gets back the money lent, together with interest.

#### 5. Equitable Mortgage or Mortgage by Deposit of Title-deeds

In Calcutta, Bombay, Madras and other towns notified by the Government a mortgage may be created by depositing the title-deeds of a property with the mortgagee. No writing or registration is required, but the deposit must be made with the intention of creating a security and not for any other purpose. The transaction may be recorded in a letter or memorandum. A mortgage by deposit of title deeds is also called Equitable Mortgage.

#### 6. Anomalous Mortgage

A mortgage which does not come within any of the above classes is called an Anomalous Mortgage. A mortgage containing a mixture of the characteristics of the different types mentioned above, comes within the category of anomalous mortgage.

### **Submortgage**

The mortgagee can mortgage the interest transferred to him by way of security. Such a mortgage is called a submortgage.

### **Subsequent Mortgages by the Mortgagor**

After a property is mortgaged to a person, the owner can mortgage it again to other persons. The person to whom the property is mortgaged at first is called the first mortgagee. The next mortgagee is called second mortgagee and so on. There may be any number of mortgagees over the same property. For purposes of payment the different mortgagees rank in order of time. The first mortgagee is paid in full first, then the second mortgagee and so on.

## **RIGHTS AND LIABILITIES OF PARTNERS**

Apart from the provisions of the mortgage deed, the mortgagor and the mortgagee have certain statutory rights and liabilities. The important right and liabilities are mentioned below.

### **Rights of Mortgagor**

#### **1. Redemption**

Any time after the principal amount secured by the mortgage becomes due, the mortgagor can get back the property by paying off the claims of the mortgagee. This right is called the Right of Redemption or the Equity of Redemption. This right is extinguished when the court so orders or when the court passes a decree for the sale of the mortgaged property. A decree of the court by which the mortgagor is prevented from exercising the right of redemption is called a *Decree for Foreclosure*. Such a decree may be passed in English mortgages.

The mortgage deed cannot impose any condition which prevents or restricts the right of redemption. Any clause in the deed which purports to do so is called a "clog on the right of redemption" and is void. When a transaction is in substance a mortgage, the court will not allow it to be converted into a sale or any other transaction. This principle is expressed in the maxim, "Once a mortgage, always a mortgage".

#### **2. Accessions**

If there is any accession (addition) to the property when the mortgagee is in possession, it goes to the mortgagor after the

property is redeemed. The same rule applies to improvements made upon the property by the mortgagee, if any.

### 3. Inspection and Copies

The mortgagor is entitled to inspect and take copies of the title deeds of the property while they are in the possession of the mortgagee.

### 4. Deposit and Suit

The mortgagor can file a suit for redemption after the mortgage money becomes due. He can also deposit the money due in court. Interest ceases to run after the mortgagee receive notice of the deposit.

### 5. Instalments

Where the transaction comes under the Money-lenders Act or any other similar statute, the court can direct the payment of money by instalments.

### 6. Lease

If the mortgagor is in possession, he can under certain circumstances grant a lease of the property.—Sec. 65A.

## Rights of the Mortgagee

1. He is entitled to incur expenditure for the protection and preservation of the property and is entitled to and such expenditure to the mortgage money. He has an insurable interest in the property.

2. He is entitled to receive the principal amount together with interest at the agreed rate, subject to the statutory provisions regarding the maximum payable rates of interest.

3. He can file a suit for the remedy appropriate to the type of mortgage entered into. The usual remedies are a suit for sale of the property and a suit for foreclosure.

4. Under certain circumstances the mortgagee can sell the mortgaged property without intervention of the court, e.g., where such a right is given by the mortgage deed.

5. Section 65 of the Transfer of Property Act provides that in the absence of a contract to the contrary, the mortgagor shall be deemed to have agreed to the following covenants :

(a) the mortgagor has title to the property and has the right to transfer the same ;

(b) there is right to quiet enjoyment of property ;

(c) the mortgagor will pay the public charges, rates and taxes due on the property ;

(d) if the mortgaged property is a lease, the rent due on it will be paid ; and

(e) the interest and principal due on prior encumbrances will be paid.

### CHARGE

A charge on an immovable property is created when it is made liable for the payment of money to another, but the transaction does not amount to a mortgage.

Section 100 of the Transfer of Property Act defines a Charge as follows: "Where an immovable property of one person is, by an act of the parties or by operation of law, made security for the payment of money to another, and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property."

"No particular form of words is necessary to create a charge and all that is necessary is that there must be clear intention to make a property security for payment of money *in praesenti*. In each case the question which the court would have to decide would be whether the agreement in question creates a charge *in praesenti*. Where there is no transfer in the interest of property, there is no mortgage." *J. K. Private Ltd. v. Kaiser-I-Hind Sp. & Wvg. Co.*<sup>1</sup>

#### *Distinction between a charge and a mortgage*

1. In a mortgage, there is transfer of an interest in some immovable property. In a charge, there is no transfer of any interest to any person.

2. In some types to mortgage there is a personal covenant to pay by the mortgagor. There is no such covenant in a charge.

3. If a mortgaged property is transferred, the transferee takes the property subject to the mortgage, whether he was aware of the mortgage or not. But if a property subject to a charge is transferred to a *bona fide* transferee for value without notice, the transferee is not bound by the charge.

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<sup>1</sup> AIR (1970) Supreme Court 1941

4. A mortgage can be created only by an act of parties. But a charge can be created by act of parties or by operation of law.

### MORTGAGE AND PLEDGE

The difference between a mortgage and a pledge or pawn can be summed up as follows :

1. Mortgage relates to immovable property ; pledge or pawn to movable property.

2. In a mortgage there is transfer of an interest in some property ; in a pawn or pledge there is only an obligation to repay money.

3. Properties pawned or pledged remain with the creditor ; in a mortgage possession of the property may be with the mortgagor or with the mortgagee.

4. The same property may be mortgaged several times ; there cannot be several pledges of the same goods.

### HYPOTHECATION

The term Hypothecation is used to describe a transaction whereby money is lent on the security of movable property but the property remains in the custody of the owner of the property. Hypothecation is also called mortgage of movables. Such transactions have been held to be valid in India although they are not dealt with in the Transfer of Property Act.

The owner of the goods which are hypothecated is called the Hypothecator. The person to whom the goods are hypothecated is called the Hypothecatee.

Hypothecation differs from mortgage on the following points : (i) Mortgage relates to immovable property ; hypothecation to movable property. (ii) In a mortgage there is transfer of some interest in the property to the creditor ; in hypothecation there is only an obligation to repay money, there is no transfer of any interest.

Hypothecation is similar to pawn or pledge, because both deal with movable property. In a pawn or pledge, however, the creditor has possession of the property ; while in hypothecation possession remains with the debtor.

The rights of the hypothecatee depend on the terms of the contract between the parties. He can file a suit to realise his dues by sale of the goods hypothecated. He may be given, by

the terms of the contract, the right to sell the goods himself (on default of payment by the due date) and to realise his dues from the sale proceeds.

The hypothecatee may lose his rights, over the goods hypothecated, under the following circumstances :

1. If the hypothecator, in possession of the goods, sells them to a *bona fide* purchaser for value without notice of the hypothecation, the purchaser gets a good title to the goods and the hypothecatee cannot proceed against them. *Sreeman Narasiah v. Bansi Reddy Venkataramiah*.<sup>1</sup>

2. If the hypothecator, in possession of the goods, makes a valid pledge of the goods and the pledgee has no notice of the hypothecation, the claims of the hypothecatee will be postponed to those of the pledgee. *Co-operative Hindusthan Bank v. Surendra*.<sup>2</sup>

### LIEN

Lien may be defined as the right to retain goods belonging to another, till some claim is satisfied. There are three kinds of lien ; (i) Possessory Lien, (ii) Maritime Lien and (iii) Equitable Lien.

#### Possessory Lien

A possessory lien is one which can be exercised only by a person in possession of goods. A possessory lien may be a General Lien or a Particular Lien.

General Lien means the right to retain *all* the goods of another in the possession of a person until *all* the claims of the possession are satisfied. General lien may be conferred by an agreement to that effect or by custom and usage or by the provisions of any statute. General lien exists in the case of solicitors, bankers, factors etc. (See p. 166-167).

Particular Lien means the right to retain goods till some claim *concerning those goods* is paid. *Examples* : Common carriers can retain goods carried by them till the charge payable in respect of those goods are paid. Other bailees have similar rights.

A possessory lien can be enforced by retaining possession. The lien-holder cannot sell the property except under certain special circumstances.

<sup>1</sup> 42 Mad. 59

<sup>2</sup> AIR (1932) Cal 524

A possessory lien is extinguished in the following cases :  
 (i) when possession is lost, (ii) when the money due is paid,  
 (iii) when the claimant takes some other security and thereby,  
 by implication, abandons the right of lien and (iv) when the right  
 of lien is waived.

### Maritime Lien

Maritime Lien is a right conferred by maritime law, specially binding a ship and her cargo, fittings and furniture, and freight for the payment of some claim. *Examples* : seamen for their wages ; salvors for their reward ; holders of a bottomry bond for the money lent, etc.

A maritime lien does not depend on possession. It can be exercised by persons not in possession by taking proceedings against the property concerned.

A maritime lien come to an end by payment, release, waiver and by the destruction of the subject-matter of the lien.

### Equitable Lien

An equitable lien means a lien which is conferred by law to enable a person to satisfy some claim over some other person's property. *Example* : an unpaid vendor of immovable property has a lien on the property for the unpaid purchase money.

An equitable lien is binding on all persons who take the property with notice of the lien. An equitable lien is enforced by a suit for the sale of the property. It is extinguished by payment of the claim and by transfer of the property to a *bona fide* purchaser for value without notice.

## EXERCISES

1. Describe Simple Mortgage and Equitable Mortgage. What are the requirements of an Equitable Mortgage? (Pages 507, 508)
2. Define Mortgage. Distinguish between a mortgage and a charge on immovable property. (Pages 506, 511)
3. Write notes on Equitable Mortgage. (Page 508)
4. How is an Equitable Mortgage effected? Distinguish between a mortgage and a charge. (Pages 508, 511)
5. What is hypothecation? When does the hypothecation lose his rights? (Pages 512-513)
6. Distinguish between Possessory Lien, Maritime Lien and Equitable Lien. (Pages 513-514)

## BOOK X

# CONSUMER PROTECTION ACT, 1986

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### Consumer Protection Act, 1986

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