Supreme Court On Capitalisation of Interest

(Central Bank of India vs. Ravindra and Others)
(AIR 2001 SC 3095)

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A batch of cases were placed before the Supreme Court of India wherein the same common question of law had arisen for decision. The constitutional bench of the Supreme Court (comprising S/Shri A.S. Anand, C.J.I., K.T. Thomas, R.C. Lahoti, N. Santosh Hegde and S.N. Variava JJ) have decided the case and also made a few incidental observations which are worth nothing. Before proceeding to the observations made by the Supreme Court, a look at the brief facts of Central Bank's case will definitely provide a better insight to the reader.

The facts in brief are that the petitioner bank had sanctioned a loan to the Respondent No. 1 on the guarantee of Respondents Nos. 2 & 3. On 21-6-1979, the Respondent No. 1 executed a demand promissory note for Rs. 1,37,720/- and also executed an agreement of hypothecation of a vehicle. The loan carried interest at the rate of 11% per annum with quarterly rests as on 31st March, 30th June, 30th September and 31st December every year. The total outstanding, inclusive of the interest charged as per agreement was Rs. 1,51,825/- on the date of the suit for recovery whereof the suit was filed by the petitioner bank. Relief was also prayed for by grant of interest pendente lite and future interest till realisation. The trial court passed a decree for Rs. 1,51,825/- with future interest at the rate of 8% from the date of the suit till realisation affording the facility of payment of the decretal amount in six quarterly instalments with exigibility clause. An appeal preferred by the Bank before the HighCourt was partly allowed modifying the decree of the trial court by awarding interest at the rate of 11% per annum and setting aside the facility of payment by instalments. However, the High Court directed the interest at the rate of 11% per annum to be payable only on Rupees 99,000/- which was stated to be the principal sum from the date of the suit till realisation though the decree for Rs. 1,51,825/-, the amount due and payable on the date of the suit was maintained. The petitioner bank being aggrieved by the decree of the High Court to the extent to which future interest at the rate of 11% per annum has not been allowed on the entire sum of Rs. 1,51,825/-, filed a special leave petition (Civil) before the Supreme Court.
As most of the borrowers were unpresented, the Court had taken the assistance of amicus curiae and decided the case. The Supreme Court has made a few incidental observations while deciding the main issue which are worth nothing.

The observations made by the Supreme Court are as under :

1. Though interest can be capitalised on the analogy that the interest falling due on the accrued date and remaining unpaid, partakes the character of amount advanced on that date, yet penal interest, which is charged by way of penalty for non-payment, cannot be capitalised. Further, interest i.e. interest on interest, whether simple or compound are panel and cannot be claimed on the amount of penal interest. Penal interest cannot be capitalised. It will be opposed to public policy.

2. Novation, that is, entering into a fresh agreement by the debtor with the creditor undertaking the payment previously borrowed principal amount coupled with interest by treating the sum total as principal, any contract express or implied and an express acknowledgment of accounts are best evidence of capitalisation. Acquiescence in the method of accounting adopted by the creditor and brought to the knowledge of the debtor may also enable interest being converted into principal. A mere failure to protest is not acquiescence.

3. The prevalence of banking practice legitimatises stipulations as to interest on periodical rests and their capitalisation being incorporated in contracts. Such stipulations incorporated in contracts voluntarily entered into and binding on the parties shall govern the substantive rights and obligations of the parties as to recovery and payment of interest.

4. The capitalisation method is founded on the principle that the borrower failed to make payment though he could have made and thereby rendered himself a defaulter. To hold an amount debited to the account of the borrower capitalised it should appear that the borrower had an opportunity of making the payment on the date of entry or within a reasonable time or period of grace from the date of debit entry or the amount falling due and thereby avoiding capitalisation. Any debt entry in the account of the borrower and claimed to have been capitalised so as to form an amalgam of the principal sum may be excluded on being shown to the satisfaction of the Court that such debt entry was not brought to the notice of the borrower and/or he did not have the opportunity of making payment before capitalisation and thereby excluding its capitalisation.

5. The power conferred by sections 21 and 35-A of the Banking Regulations Act, 1935 is coupled with the duty to act. Reserve Bank of India is prime banking institution of the country entrusted with a supervisory role over banking and conferred with the authority of issuing binding directions, having statutory force, in the interest of public in general and preventing banking affairs from deterioration and prejudice as also to secure the proper management of any banking company generally. Reserve Bank of India is one of the vatchdogs of finance and economy of the nation. It is, and it ought to be, aware of all relevant factors, including credit conditions as prevailing, which would inviate its policy decisions. RBI has been issuing directions/ circulars from time to time which, inter alia, deal with rate of interest which can be charged and the periods at the end of which rests can be had, interest calculated thereon and charged and capitalised. It should continue to issue such directions. Its circulars shall bind those who fall within the net of such directives. For such transactions which are not squarely governed by such circulars, the RBI directives may be treated as standards for the purpose of deciding whether the interest charged is excessive, usurious or opposed to public policy.

6. Agricultural borrowing are to be treated on a pedestal different from others. Charging and capitalisation of interest on agricultural loans cannot be permitted in India except on annual or six monthly rests depending on the rotation of crops in the area to which the agriculturist borrowers belong.

7. Any interest charged and/or capitalised in violation of RBI directives, as to rate of interest, or as to periods at which rests can be arrived at, shall be disallowed and/or excluded from

capital sum and be treated only as interest and dealt with accordingly.

8. Award of interest pendente lite and post-decree is discretionary with the Court as it is essentially governed by Section 34 of the CPC dehors the contract between the parties. In a given case, if the Court finds that in the principal sum adjudged on the date of the suit, the component of interest is disproportionate with the component of the principle sum actually advanced, the Court may exercise its discretion in awarding interest pendente lite and post-decree interest at a lower rate or may even decline awarding such interest. The discretion shall be exercised fairly, judiciously and for reasons and not in an arbitrary or fanciful manner.

The Supreme Court further said that it is expected henceforth from the banks, bound by the directives of Reserve Bank of India, to make averment in the plaint that interest/compound interest has been charged at such rates, and capitalised at such periodical rests, as are permitted by and do not run counter to the directives of the Reserve Bank of India. The Court has also directed that a statement of account shall be filed in the court showing details and giving particulars of debt entries, and if debt entry relates to interest then settling out also the rate of, and the period for which, the interest has been charged. On the Court being prima facie satisfied, if a dispute is raised in this regard, of the permissibility of debits, the onus would be on the borrower to show why the amount of debit balance appearing in the footnote of the account and claimed as principal sum cannot be so accepted and adjudged. As a gesture it is said that this practice would narrow down the scope of controversy in suits filed by banking institutions and enable an expeditious disposal of the suits, the issues wherein are by and large capable of determined by documentary evidence.

The Supreme Court has also further emphasised that RBI directives have not only statutory flavour, any contravention thereof or any default in compliance therewith is punishable under Sub-regulation (4) of Section 46 of B.R.Act, 1949. The Court can act on the assumption that the transactions or dealings have taken place and accounts maintained by the Bank are inconformity with the RBI directives. Finally, while answering the main question the Supreme Court has stated as follows :

a) Subject to a binding stipulation contained in a voluntary contract between the parties and/ or an established practice or usage interest on loans and advances may be charged on periodical rests and also capitalised on remaining unpaid. The principal sum actually advanced coupled with the interest on periodical rests so capitalised is capable of being adjudged as principal sum on the date of the suit.

b) The principal sum so adjudged is ‘such principal sum’ within the meaning of Section 34 of CPC, 1908 on which interest pendente lite and future interest i.e. post-decre interest, at such rate and for such period which the Court may deem fit, may be awarded by the Court.

c) The proposition as laid down in AIR 1994 SCW 2721 = 1994 (5) SCC 213 and 1996 (5) SCC 280 have been correctly decided.

Finally, the Court said that all the appeals and SLPs be referred to an appropriate bench for decision.

Would you say that all men are equal in excellence, or is one man better than another?

The latter.

— PLATO, The Republic, Book V, "On Matrimony and Philosophy,"
in The World's Great Classics (New York : The Colonial Press, 1901), p.146

Recent Judgements Relevant To Bankers

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I. Charanjit Singh Chadha and Ors. vs. Sudhir Mehra — (2001) 7 SCC 417

Principle

Disputes under hire purchase agreements have to be resolved on the basis of the terms incorporated in the agreement. The recovery of possession of goods by the owner/financier as per the terms of the hire purchase agreement does not amount to a criminal offence. Hire purchase agreement is an executory contract of sale conferring no right in rem to the hirer until the conditions for transfer of the property have been fulfiled.

Facts

The Respondent entered into hire purchase agreement with the appellant in respect of a motor vehicle. The total consideration agreed to be paid was Rs. 3,02,884 out of which Rs. 69,308 was paid by the Respondent to the appellant. He had agreed to pay the balance in 36 monthly installments of Rs. 8,400 each. In terms of the hire purchase agreement the hirer would not become the owner of the vehicle until he pays the entire installments. The owner has the right to repossess the vehicle in case of default by the hirer. The owner has also right to enter any building, premises or place where the vehicle may be or is supposed to be for the purpose of inspection, repossession or attempt to repossess the vehicle and the owner of the vehicle will not be liable for any civil or criminal action at the instance of the hirer. The agreement also made clear that the hirer would be liable for all the expenses of the owner in obtaining repossession or attempting to obtain the prepossession of the vehicle.

The Respondent had filed a criminal complaint under Section 406, 420 and 120B of IPC before the judicial Magistrate, Amritsar alleging that the Respondents had forcibly taken away the vehicle from the motor mechanic when the vehicle was kept with the motor mechanic for carrying out repairs. The Magistrate took cognizance of the offence and issued summons to theAppellant. The petition filed by the Appellant under section 482 of the Criminal Procedure Code, 1973 before the High Court of Punjab and Haryana to quash the complaint proceedings was dismissed on the ground that the allegations in the complaint were capable of making out an offence punishable under Section 379 of IPC. Aggrieved by the same, the appellant had the filed this criminal appeal.

Observations of the court

The hirer would not become the owner of the property until he repays the entire installments. Hire purchase agreements are executory contract under which the goods are let on hire and the hirer has an option to purchase in accordance with the terms of the agreement. Under the hire purchase agreement, the hirer is simply paying for the use of the goods and for the option to purchase them. Mere contract of hiring does not create a title to the hirer but the option to purchase on fulfillment of certain conditions. The Court has also relied upon its previous judgement in K.L. Johar & Co. v s. CTO (AIR 1965 SC 1082), Installment Supply (P) Ltd. vs. Union of India (AIR 1962 SC 53) and Sundaram Finance Ltd. vs. State of Kerala (AIR 1966 SC 1178) wherein it was held that a hire purchase agreement has two elements, (1) Element of bailment and (2) Element of Sale, in the sense that it contemplates an eventual sale. The element of sale fructifies when the option is exercised by the indenting purchaser after fulfilling the terms of the agreement. When all the terms of the agreement are satisfied and the option is exercised, a sale takes place of the goods which till then had been hired. When the hire purchase agreement specifically says that the owner has got a right to repossess the vehicle, there cannot be any basis for alleging that the appellants had committed theft, criminal breach of trust, cheating or criminal conspiracy as alleged in the complaint. The appellants took the repossession of the vehicle in exercise of their rights under the agreement.

Decision

The appeal is allowed and the impugned order passed by the High Court is set aside. The complaint and the other proceedings initiated pursuant to that are quashed.

II. Kerala Small Financiers Association & Others vs. Union of India and Others — JT 2001(10) SC 27

Principle

Section 45-S of the Reserve Bank of India Act, 1934 is a valid piece of legislation and the legislature had competence to enact Section 45-S.

Facts

The petitioners have challenged the legislative competence of the Parliament to enact Section 45-S of the Reserve Bank of India Act on the ground that in respect of persons who are registered under the Money Lenders Acts passed by the various States, their business cannot be brought to an end by virtue of Section 45-S. Further, it was argued that the said Section was enacted in exercise of powers conferred on the State legislatures under entry 30 of list II. Section 45-S prevents unincorporated bodies and persons from accepting deposits though they are registered money lenders.

Observations of the Court

The Supreme Court relied on the decision in Kanta Mehta vs. Union of India and Others [1987 (62) Company Cases 769] wherein the High Court of Delhi considered the legislative competence of the Parliament to enact Section 45-S of the Reserve Bank of India Act, and held that under entry 45, list I of the Seventh Schedule the said provision had been validily enacted. Following the above, the Supreme Court had upheld the legislative competence of the Parliament to enact the said provision in T. Velayudhan Achari and Another vs. Union of India & Others [JT

1993(1) SC 580]. The provisions of the State laws relating to money lenders cannot have the effect of overriding the provisions of Section 45-S of the Reserve Bank of India Act. The said section is a valid piece of legislation and it binds all persons referred to therein.

Decision

Appeals are dismissed.

III. T.S. Premkumar vs. Tamil Nadu Mercantile Bank Ltd. — Petition Under Section 111A(2) of the Companies Act — (2001) 33 SCL 802 (CLB, Chennai)

Facts

The Petitioner is the registered holder of 171 shares of the respondent Bank. Further, he had purchased another 660 shares of the Bank and lodged the shares along with transfer instrument for registration on 23rd February 1999. The Bank returned the transfer instrument by its letter dated 6-3-99 stating that the share transfer stamps had not been properly cancelled and that proper transfer fee had not been remitted. The petitioner had complied with all the above requirements and resubmitted the same on 15-3-99. However, the Bank returned the transfer instrument again and again on a number of occasions on the ground of non-fulfillment of certain requirements. Finally the Bank asked the petitioner to submit information relating to income-tax return, nominees and also source of consideration. The Bank also informed the petitioner that the information is required to comply with the requirements of the guidelines issued by RBI on 16-4-94. In the petition, the petitioner had sought direction from the company Law Board to the Bank to register the transfer of shares in his name.

Observations of the Board

The Bank is a public company governed by the provisions of the Companies Act. In terms of Section 111A(2) of the Companies Act, the share of a public company are truly transferable. Though the Bank had not refused the transfer of shares, the action of returning the transfer instrument on a number of occasions on the ground of non-fulfillment of certain requirements has to be construed as a deemed denial. The Bank had relied on the guidelines dated 16-4-94 issued by RBI for seeking information from the petitioner. The guidelines provide that even in a case where acquisition is below 1% of the total paid up capital, the Bank should be vigilant about any move made through the back door by individuals or groups to corner shares of the Bank. The information sought for by the Bank has no nexus to the spirit of the guidelines of RBI. The guidelines are basically to alert the Board of Directors of the Bank regarding manipulation in acquisition of shares to gain controlling interest in the banks. In the present petition, only meager percentage of shares are involved for registration and the petitioner has already furnished all the information called for by the Bank.

Order

The CLB issued a direction to the Bank to register the transfer of shares within a month from the date of tender of the transfer instrument along with the information relating to the petitioner's employment and bank account details.

IV. M/s Uniplast India Ltd. and Others vs. State (Govt. of NCT of Delhi) and Others — AIR 2001 SC 2625

Principle

Notice issued under Section 434 of the Companies Act within 15 days of return of cheque as unpaid cannot be treated as notice under Section 138 of the Negotiable Instruments Act, 1881.

Facts

The third appellant is the Managing Director of the first appellant Company of which the second appellant is Vice-President. Two cheques for a sum of Rs. 50 lakhs and 3 lakhs, issued by the first appellant in favour of the respondent were dishonoured by the Oriental Bank of Commerce vide memo dated 23rd February 1996. Notice dated 2nd March 1996 was sent to the appellants calling upon them to pay the amount. A complaint was filed on 11th April 1996 before the Magistrate's Court as the appellants did not pay the amount within the statutory period.

The stand taken by the appellant was that the cheques were earlier presented by the payee and issued notice on 1-12-1995 when it was dishonoured. But the payee did not file a complaint within a month of the expiry of 15 days after the said notice and hence he cannot create one more cause of action by presenting the cheque once again. In support of this contention, the appellants cited the decision in Sadanandan Bhadran vs. Madhavan Sunil Kumar (1998) 6 SCC.514. The trial court dismissed the said contention on the ground that the notice issued on 1-12-1995 was under Section 434 of the Companies Act, which cannot be treated as a notice under Section 138 of the Negotiable Instrument Act, 1881. The single Judge of the High Court upheld this position. Aggrieved by said order the appellants preferred this appeal before the Supreme Court.

Observations of the Court

The Supreme Court did not accept the contention of the appellants that the High Court went wrong in saying that a notice under Sections 433 and 434 of the Companies Act cannot be treated as a notice under Section 138 of the Negotiable Instruments Act. The Court repelled the argument of the appellants that any notice containing a demand for payment of the amount covered by the dishonoured cheque can as well be a notice under Section 138 of the Negotiable Instrument Act 1881. Sections 433 & 434 of the Companies Act deal with the cases in which a company may be wound up by the Court. In terms of Clause (a) of Section 434 a creditor can make a demand requiring the Company to pay the amount due to him. A notice issued accordingly requiring the Company to make payment cannot be treated as a notice as contemplated under Section 138 of the Negotiable Instruments Act 1881.

Decision

The appeal is dismissed.

V. Syed Rahimuddin vs. Director General CSIR and Others AIR 2001 SC 2418

Principle

Non-production of certain documents by the department during the course of domestic enquiry does not amount to denial of reasonable opportunity to the delinquent to defend his case.

Facts

The delinquent employee was called upon to answer the charges brought against him in a regular departmental enquiry. Before the Enquiry Officer, the delinquent employee requested for

production of certain documents. The Enquiry Officer directed the departmental authorities to give copies of documents to the delinquent. However, the delinquent employee had alleged that some of those documents were not produced. On the basis of the materials produced before him the Enquiry Officer came to the conclusion that the charges brought against the delinquent employee had been proved by the departmental authorities. According to the report submitted by the Enquiry Officer, the disciplinary authority imposed the punishment of compulsory retirement after coming to the conclusion that the charges brought against the delinquent employee had been proved beyond any doubt. The appeal preferred before the appellate authority was dismissed. Aggrieved by the order of the appellate authority, the delinquent employee approached the Central Administrative Tribunal, Hyderabad. The CAT held that there was no infirmity in the inquiry proceedings and hence the principles of natural justice had not been violated and therefore the order of punishment cannot be interfered with. This appeal before the Supreme Court is against the order passed by the CAT.

Arguments of the appellants

Inspite of the order passed by the Enquiry Officer to produce the documents, the departmental authorities had not produced certain documents. Non-production of the documents itself tantamounts to denial of reasonable opportunity to the delinquent employee to defend his case and the Tribunal was in error in not accepting the said contention. Secondly, the key defence witness though he had been summoned did not depose on being pressurised by the Enquiry Officer and that itself would vitiate the conclusion of the Enquiry Officer. Further, it was argued that the conclusion arrived at by the Enquiry Officer is without any evidence. Lastly, it was submitted that the Enquiry Officer is biased and the Tribunal did not apply its mind to the relevant parts of the Enquiry Officer's report.

Observations of the Court

After considering the facts of the case, the Court observed that the delinquent employee was not really prejudiced by non-supply of certain documents though the production of the same was ordered by the Enquiry Officer. Hence, the Tribunal rightly came to the conclusion that the non-production of such documents cannot be treated as denial of reasonable opportunity to the delinquent in making his defence. As regards the examination of the key witness, para 18 of the order passed by the Tribunal has dealt with the same. It appears that he was duly summoned and he did appear but refused to say anything in favour of the delinquent. This cannot be treated to be a lacuna in the enquiry proceedings. After examining the report of the Enquiry Officer, the Court did not accept the contention of the appellant that the Enquiry Officer came to the conclusion without evidence or that he was biased.

Decision

Appeal stands dismissed.

VI. R. Rajagopal vs. S.S. Venkat — Criminal Appeal Nos. 170 to 172 of 2000 — Arising out of S.L.P. (Cri) Nos. 3142 to 3144 of 1999) — AIR 2001 SC 2432

Principle

A company/partnership firm on whose behalf the dishonoured cheque was issued was not a

necessary party to the complaint under Section 138 of the Negotiable Instruments Act.

Facts

The cheque issued by the Respondent on behalf of a company was dishonoured. The Appellant filed a Criminal Complaint under Section 138 of Negotiable Instruments Act, 1881. The High Court quashed the complaint on the ground that the company/partnership firm on whose behalf the cheque was issued was not made an accused in the complaint. The Respondent who is a partner had been made an accused. In the appeal filed by the Complainant/Appellant, the Supreme Court, set aside the impugned order passed by the High Court and directed the trial court to proceed with the trial. The Court also relied on the decision in Anil Hada vs. Indian Acrylic Ltd. (AIR 2000 SC 145).

Decision

Appeal are allowed.

VII. K.N. Beena vs. Muniyappan — Criminal Appeal No. 1066 of 2001 (arising out of S.L.P. (Cri) No. 969 of 2001) — AIR 2001 SC 2895

Principle

The accused has to prove by leading cogent evidence that there was no debt or liability due to the complainant. Mere denial/averments in reply made by the accused are not sufficient to prove that no debt or liability are due to the complainant.

Facts

A cheque dated 6th April 1993 for a sum of Rs. 63,720 issued by the 1st respondent in favour of the appellant on the Central Bank was dishonoured due to insufficient funds. The appellant filed a

Criminal Complaint under Section 138 of the Negotiable Instruments Act, 1881 before the Judicial Magistrate's Court. The Court convicted the 1st Respondent under Section 138 and directed payment of a fine of Rs. 65,000/- In default the 1st respondent had to undergo simple imprisonment for 1 year. The Sessions Court dismissed the appeal filed by the convict. In the 2nd appeal before the High Court of Madras, the Court acquitted the 1st respondent on the ground that the complainant had not proved that the cheque was issued for any debt or liability. Aggrieved by the said order, the complainant preferred this appeal before the Supreme Court.

Observations of the Court

It was observed that under Section 118 of the Negotiable Instruments Act, 1881 unless the contrary was proved it is to be presumed that the Negotiable Instrument was made or drawn for consideration. Section 139 provides that the Court has to presume, unless the contrary was proved that the holder of the cheque received the cheque for discharge in whole or in part of a debt or liability. Thus in complaints under Section 138, the Court has to presume that the cheque was issued for a debt or liability. The burden of proving that the cheque was not issued for a debt or liability rests on the accused. The Court had also relied on the decision in Hiten P. Dalal vs. Bratindranath Banerjee (2001) 6 SCC 16. The 1st Respondent had to prove by leading cogent

evidence that there was no debt or liability. As the 1st Respondent not having discharged the burden of proving that the cheque was not issued for a debt or liability, the conviction awarded by the trial court was correct and the High Court erroneously set aside the conviction.

Decision

The impugned order passed by the High Court is set aside. The conviction and sentence awarded by the Magistrate stand.