

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 232 OF 2016

The Maharashtra State Co-operative Bank Ltd. ...Appellant

Versus

Babulal Lade & Ors. ...Respondents

J U D G M E N T

MOHAN M. SHANTANAGOUDAR, J.

1. This appeal arises out of judgment dated 01.12.2015 passed by the Nagpur Bench of the High Court of Bombay in W.P. No. 3879/2012. Vide the impugned judgment, the Hon'ble High Court has directed the issuance of a recovery certificate against the Appellant herein, thereby modifying the order dated 08.08.2011 passed by the Bhandara Bench, Industrial Court, Maharashtra.

2. The brief facts giving rise to this appeal are as follows:

2.1 Registered under the Maharashtra Co-operative Societies Act, 1960 (*hereinafter* 'Societies Act'), Respondent No. 6 herein,

Vainganga Sahakari Sakhar Karkhana Ltd. (*hereinafter* 'Karkhana') had obtained credit facilities from the Appellant-Bank and mortgaged its properties in return. When it defaulted on the repayment of the loan, the Appellant-Bank initiated recovery proceedings on 10.02.2005, by issuing a notice under Section 13(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (*hereinafter* 'SARFAESI Act'). Later, on 13.06.2005, the Appellant-Bank took physical possession of the mortgaged properties of the Karkhana as per Section 13(4) of the SARFAESI Act.

2.2 Owing to its poor financial condition, on 24.01.2006, the Karkhana issued a notice to its employees directing them to proceed on leave without salary w.e.f. 24.02.2006. This was challenged by representatives of the Karkhana employees (Respondent Nos. 1 to 3 herein) in ULPA No. 65/2006 filed under Section 28 read with items 9 and 10 of Schedule IV of the Maharashtra Recognition of Trade Unions & Prevention of Unfair Labour Practices Act, 1971 (*hereinafter* 'MRTU & PULP Act'). Vide order dated 24.08.2006, the Industrial Court quashed the notice and held that it amounted to an unfair labour practice. Further, noting that Karkhana had not paid salaries to its employees since

July 2003, the Industrial Court directed the Karkhana to pay the unpaid salaries on top priority basis from any funds that may become available with it.

2.3 On the basis of this order, Respondent Nos. 1 to 3 filed a miscellaneous application, ULPA No. 5/2007, seeking the issuance of a recovery certificate against the Karkhana, its Managing Director (Respondent No. 4 herein), and the Appellant-Bank under Section 50 of the MRTU & PULP Act. It is to be noted that the Appellant was arraigned as a party in this proceeding for the first time. Vide order dated 27.04.2007, the Industrial Court held that a recovery certificate for unpaid salaries of the Karkhana employees could not be issued against the Appellant-Bank. It also refused to issue such a certificate against the Karkhana and its Managing Director in view of the precarious financial condition of the Karkhana. However, the Karkhana was directed to pay the unpaid salaries to the employees on top priority basis, as and when funds were to become available.

2.4 In the challenge against this order in W.P. No. 4746/2007, the High Court of Bombay, vide order dated 12.07.2010, held that recovery could only be made against the Karkhana and not the Appellant-Bank, as there was no employer-employee relationship

between the Bank and the employees. It was further held that the Industrial Court had erred in relying upon the non-availability of funds with the Karkhana to refuse the grant of a recovery certificate, as the relevant consideration for issuance of such a certificate is the entitlement of the applicants and not the financial condition of the employer. In view of this, the High Court directed the issuance of a recovery certificate against the Karkhana and its Managing Director. Pursuant to this direction, the Industrial Court, vide order dated 08.08.2011, disposed of ULPA No. 5/2007 by issuing a recovery certificate of Rs.13,89,84,334 against the Karkhana and its Managing Director. However, the prayer to issue a recovery certificate against the Appellant-Bank was rejected.

2.5 In the interim period, on 26.08.2010, one of the attached properties of the Karkhana was auctioned and sold by the Appellant-Bank to one Purti Power and Sugar Ltd. (Respondent No. 5 herein). According to the terms and conditions of this sale, the purchaser had accepted all encumbrances on the property as agreed upon in the sale letter. It is found that the proceeds from this sale were appropriated by the Appellant-Bank towards the amount due to it from the Karkhana.

2.6 At the same time, aggrieved by the non-issuance of a recovery certificate against the Appellant, Respondent Nos. 1 to 3 filed W.P. No. 3879/2012. During the pendency of this petition, on 19.01.2013, an order was passed by the competent authority under the Societies Act directing the liquidation of the Karkhana. Finally, vide the impugned judgment dated 01.12.2015, the High Court disposed of W.P. No. 3879/2012. It was observed that in terms of Section 50 of the MRTU & PULP Act, the recovery certificate should have been issued to the Collector for recovering the amount from the Karkhana and its Managing Director. Thus, the order of the Industrial Court dated 08.08.2011 was modified to this extent to clarify that the certificate is to be issued to the Collector first, who would then proceed to recover the sum as per the recovery certificate. On the question of whether the Collector could effectuate such recovery from sale proceeds of the attached property of the Karkhana, it was held that after the auction sale, the Appellant-Bank held the proceeds in trust as per Section 13(7) of the SARFAESI Act and did not have a first charge over them. Further, it was found that upon the liquidation of the Karkhana on 19.01.2013, Section 529A of the Companies Act, 1956 (*hereinafter* 'Companies Act') came into operation, thereby

according employees' dues priority over all other dues in respect of the sale proceeds. In light of this, it was held that the Collector could recover the said amount of Rs.13,89,84,334 from the sale proceeds held in trust by the Appellant-Bank. It is against this order that the instant appeal has been filed.

3. Heard learned Counsel for both the parties.

4. Learned Senior Counsel for the Appellant argued that the High Court erred in applying Section 529A of the Companies Act, as Section 167 of the Societies Act specifically bars the application of the Companies Act to co-operative societies, as is the case with the Karkhana here. In any case, he submitted that Section 529A of the Companies Act was misapplied, as the proviso to Section 13(9) of the SARFAESI Act requires the company to be "in liquidation" at the time of the sale of secured assets for Section 529A to apply. Given that the Karkhana only went into liquidation on 19.01.2013, i.e. after the sale of its properties in 2010, he argued that the provision was wrongly applied. In light of this, he also submitted that there is no other provision that makes employees' dues a paramount charge, and the Appellant-Bank, being a secured creditor, should be given precedence over the proceeds from the auction sale as per Section 13(7) of the

SARFAESI Act. It was also his contention that a claim for unpaid salaries cannot lie against the Appellant, as there is no employer-employee relationship between the Appellant-Bank and the said employees.

5. On the other hand, learned Senior Counsel for Respondent Nos. 1 to 3 drew our attention to Section 50 of the MRTU & PULP Act, under which the recovery certificate had been issued by the Industrial Court on 08.08.2011. Noting that this provision makes employees' dues recoverable in the same manner as arrears of land revenue, learned Senior Counsel referred us to Section 169(1) of the Maharashtra Land Revenue Code, 1966 (*hereinafter* 'Land Revenue Code'), which makes arrears of land revenue a paramount charge on the land. Relying on this, he submitted that the employees' dues, recoverable as arrears of land revenue, should be given primacy over the claim of the Appellant-Bank while dealing with the proceeds from the auction sale.

6. In addition to this, learned Counsel for Vainganga Sahakari Sakhar Karkhana Mazdoor Sangh (Respondent No. 8 herein) relied on the sale letter dated 08.03.2010, which was issued by the Appellant-Bank prior to the sale of the properties of the Karkhana. In this letter, the Appellant-Bank had stated that it would take

responsibility for employees' dues. In light of this, it was argued that the Appellant cannot be absolved of its liability towards the payment of employees' dues. Learned Counsel for the subsequent purchaser of the property (Respondent No. 5 herein) similarly relied on this letter to submit that the liability for the payment of employees' dues must be placed on the Appellant.

7. In view of the arguments raised and the material on record, the issue that arises for our consideration in this appeal is whether, in the facts of this case, employees' dues can take precedence over the claim of the secured creditor in respect of the proceeds from sale of secured assets of the Karkhana under the SARFAESI Act.

8. At the outset, we find merit in the argument raised by learned Senior Counsel for the Appellant that the High Court erred in applying Section 529A of the Companies Act to this case. It would be apposite to refer to Section 167 of the Societies Act in this regard:

“167. Companies Act not to apply – For the removal of doubt, it is hereby declared that the provisions of the Companies Act, 1956 shall not apply to societies registered or deemed to be registered; under this Act.”

It is clear that Section 167 creates an express bar on the applicability of the Companies Act to societies registered under the

Societies Act. Given that the Karkhana was a co-operative society registered under the said Act, we find that Section 167 is squarely applicable, and the High Court committed a grave error in relying upon Section 529A of the Companies Act. Thus, the employees cannot make use of Section 529A of the Companies Act to claim priority over all other debts of the Karkhana.

9. Against this backdrop, the next question to be considered is whether the employees' dues can take priority over other claims by virtue of being recoverable as arrears of land revenue. Section 50 of the MRTU & PULP Act and Section 169 of the Land Revenue Code are relevant in this regard. Section 50 of the MRTU & PULP Act reads as follows:

“50. Recovery of money due from employer – Where any money is due to an employee from an employer under an order passed by the Court under Chapter VI, the employee himself or any other person authorized by him in writing in this behalf, or in the case of death of the employee, his assignee or heirs may, without prejudice to any other mode of recovery, make an application to the Court for the recovery of money due to him, and if the Court is satisfied that money is so due, it shall issue a certificate for the amount to the Collector, who shall, proceed to recover the same in the same manner as an arrear of land revenue...”

Section 169 of the Land Revenue Code is reproduced hereunder:

“169. Claims of State Government to have precedence over all others– (1) The arrears of land revenue due on account of land shall be a paramount charge on the land and on every part thereof and shall have precedence over any other debt, demand or claim whatsoever, whether in respect of mortgage, judgement-decree, execution or attachment, or otherwise howsoever, against any land or the holder thereof.

(2) The claim of the State Government to any monies other than arrears of land revenue, but recoverable as a revenue demand under the provisions of this Chapter, shall have priority over all unsecured claims against any land or holder thereof.”

10. From a reading of these provisions, it is evident that dues of employees in respect of which an order has been made by a Court under Chapter VI of the MRTU & PULP Act are recoverable in the same manner as arrears of land revenue. It was argued by learned Senior Counsel for Respondent Nos. 1 to 3 that such treatment of employees' dues as arrears of land revenue makes it a charge paramount to all other claims in view of Section 169(1) of the Land Revenue Code. In response, learned Senior Counsel for the Appellant contended that the instant case falls under Section 169(2) of the Land Revenue Code, which deals with monies other than arrears of land revenue but which is recoverable *as a revenue demand*. Since Section 169(2) only accords priority over unsecured claims, he submitted that the Appellant's claim, being that of a

secured creditor, would still have priority over employees' dues recoverable as arrears of land revenue.

10.1 It is important to appreciate that there is a material difference between arrears of land revenue due on account of land, and amounts other than arrears of land revenue but *recoverable in the same manner* as arrears of land. On a close reading of sub-sections (1) and (2) of Section 169 of the Land Revenue Code, it becomes clear that Section 169(1) deals with the former category of claims and makes them a paramount charge on the land over all other claims. On the other hand, Section 169(2) deals with the latter category and gives them priority only over unsecured claims.

10.2 This distinction has also been noted in ***SICOM Ltd. v. State of Maharashtra & Anr.***, (2010) 6 Bom CR 749, where a division Bench of the High Court of Bombay was called upon to consider whether sales tax dues of a company in liquidation, which were recoverable as arrears of land revenue under Section 38-B of the Bombay Sales Tax Act, 1959, created a first charge. While discussing the scheme of Section 169 of the Land Revenue Code, the division Bench drew upon the reasoning of the Constitution Bench of this Court in ***Builders Supply Corporation v. Union of India***, AIR 1965 SC 1061 and observed as follows:

“10. Perusal of the above quoted provisions shows that the Maharashtra Land Revenue Code makes a clear distinction between the sum which is recoverable as a land revenue and sum which is recoverable as arrears of land revenue. What creates paramount charge is the sum which is the amount of land revenue and not the sum which is recoverable as land revenue. The Constitution Bench of the Supreme Court in its judgment in the case of **Builders Supply Corporation**, referred to above, in our opinion, has made the position absolutely clear. Following observations in the case of Builders Supply Corporation, in our opinion, are relevant. They read as under:-

“We have referred to this decision, because it brings out emphatically the real character of the provisions prescribed by s. 46(2). Section 46(2) does not deal with the doctrine of the priority of Crown debts at all; it merely provides for the recovery of the arrears of tax due from an assessee as if it were an arrear of land revenue. This provisions cannot be said to convert arrears of tax into arrears of land revenue either, all that it purports to do is to indicate that after receiving the certificate from the Income-tax Officer, the Collector has to proceed to recover the arrears in question as if the said arrears were arrears of land revenue. We have already seen that other alternative remedies for the recovery of arrears of land revenue are prescribed by sub-sections (3) and (5) of s. 46. In making a provision for the recovery of arrears of tax, it cannot be said that s. 46 deals with or provides for the principle of priority of tax dues at all; and so, it is impossible to accede to the argument that s. 46 in terms displaces the application of the said doctrine in the present proceedings.”

(emphasis supplied)

This difference in the scope of sub-sections (1) and (2) of Section 169 of the Land Revenue Code was again noted by the High Court of Bombay in **City Co-op Credit & Capital Ltd. & Anr. v. Official Liquidator of Satwik Electric Controls Pvt Ltd.**, (2019) 4 Bom CR 274.

10.3 When we look to the facts of the instant case, it is seen that the recovery certificate issued under Section 50 of the MRTU & PULP Act only makes employees' dues *recoverable as arrears of land revenue*. Thus, in view of the foregoing discussion, it is clear that such employees' dues would fall under the category of claims captured by Section 169(2), and can only take priority over unsecured claims.

10.4 Further, as has been held by this Court in **Central Bank of India v. State of Kerala**, (2009) 4 SCC 94, only *expressly created* statutory first charges under Central and State laws can take precedence over the claims of secured creditors under the SARFAESI Act. It is not enough to merely provide for recovery of dues as arrears of land revenue. Given that Section 50 of the MRTU & PULP Act falls short of expressly making the employees' dues a 'first charge', it cannot be said that such dues have priority over the claims of the Appellant-Bank, which is a secured creditor.

Thus, we find that under the scheme of the Land Revenue Code and the MRTU & PULP Act, the employees' dues cannot claim priority over the claim of the Appellant-Bank.

11. However, this does not mean that the Appellant-Bank automatically holds a paramount charge over the proceeds from the sale of the secured assets. Under the scheme of the SARFAESI Act, there is nothing to show that a priority is created in favour of banks, financial institutions, and other secured creditors as against a first charge specifically created under any other statute. This has been captured succinctly by this Court in **Central Bank** (supra) as follows:

“**126.** While enacting the DRT Act and the Securitisation Act, Parliament was aware of the law laid down by this Court wherein priority of the State dues was recognized. If Parliament intended to create first charge in favour of banks, financial institutions, or other secured creditors on the property of the borrower, then it would have incorporated a provision like Section 529-A of the Companies Act or Section 11(2) of the EPF act and ensured that notwithstanding series of judicial pronouncements, dues of banks, financial institutions and other secured creditors should have priority over the State's statutory first charge in the matter of recovery of the dues of sales tax, etc. However, the fact of the matter is that no such provision has been incorporated in either of these enactments despite conferment of extraordinary power upon the secured creditors to take possession and dispose of the secured assets without the intervention of the court or Tribunal. The reason for this omission appears to be that the new

legal regime envisages transfer of secured assets to private companies.”

Thus, in the absence of a paramount charge created in favour of the employees’ dues under the MRTU & PULP Act, it cannot be said that the Appellant-Bank automatically gets a first charge under the SARFAESI Act.

12. In this light, what becomes relevant for the instant case is the scheme of the SARFAESI Act in relation to the manner of distributing the money received by the secured creditor through the sale of secured assets. The following parts of Section 13 of the SARFAESI Act are relevant in this regard:

13. Enforcement of security interest – (4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:— (a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset...

xxx

(7) Where any action has been taken against a borrower under the provisions of sub-section (4), all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the

secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

Section 13(4) of the SARFAESI Act allows a secured creditor to take possession of the secured assets of a borrower-in-default, including the right to transfer them by way of sale. What may be done with the proceeds from such sale is provided under Section 13(7). In the absence of a contract to the contrary, such proceeds are held by the secured creditor in trust and are to be applied *first* towards payments of costs, charges, and expenses incurred with respect to the sale; *second*, towards dues of the secured creditor; and *lastly*, towards any person entitled to the residue money.

13. In the facts of the present case, in exercise of its powers under Section 13(4)(a) of the SARFAESI Act, the Appellant-Bank had taken possession of the property of the Karkhana on 13.06.2005. Later, vide sale letter dated 08.03.2010, the Appellant-Bank had offered to sell the said property to one M/s Vidarbha Realities Pvt. Ltd. for a total consideration of Rs. 14.10 crores. Notably, this letter stated that the Appellant-Bank would take responsibility for employees' dues, and all other liabilities including statutory liabilities would rest solely on the purchaser. This letter was followed by a sale certificate dated 14.09.2010 recording the sale

of the property by the Appellant-Bank in favour of M/s Wainganga Sugar and Power Ltd. for a consideration of Rs. 14.10 crores.

13.1 Before delving into the applicability of the distribution of the sale proceeds as per Section 13(7) of the SARFAESI Act, we note that the sale letter dated 08.03.2010 can be relied upon by this Court. The contention of the learned Senior Counsel for the Appellant that the sale letter dated 08.03.2010 was addressed to a different entity than the company mentioned in the sale certificate dated 14.09.2010 cannot be accepted. It is found that the addressee in the sale letter dated 08.03.2010, M/s Vidarbha Realties Private Limited, had been renamed as M/s Wainganga Sugar and Power Private Limited as notified on 05.04.2010. Subsequently, on 03.06.2010, M/s Wainganga Sugar and Power Private Limited was converted to a public limited company and its name was changed to M/s Wainganga Sugar and Power Limited, which is also the name of the purchaser indicated on the sale certificate. These interim developments between March 2010 and September 2010 explain why the sale letter dated 08.03.2010 and the final sale certificate issued on 14.09.2010 reflect different names. However, since it is only a case of change in name of the company, we find that the two entities are the same and the

subsequent purchaser, Respondent No. 5 herein (successor of Wainganga Sugar and Power Ltd.) would be bound by the terms of the sale letter dated 08.03.2010.

13.2 Further, it cannot be said that the sale letter dated 08.03.2010 is an external document and cannot be relied upon to interpret the sale certificate. This is because the sale certificate specifically references the sale letter by providing that the purchaser accepts “*all the encumbrances presently there on the property and may arise in future and agreed to to pay the same as per the sale letter accepted by the purchaser*”. In view of such wording, we find that the parties intended that the sale letter dated 08.03.2010 be read harmoniously with the sale certificate inasmuch as it appears that the same is a part of the sale certificate. When a composite reading of the sale certificate dated 14.09.2010 and the sale letter dated 08.03.2010 is undertaken, it is revealed that though the purchaser had accepted all encumbrances on the property, this did not include employees’ dues in view of the specific undertaking by the Appellant-Bank that it would pay them. Given that the certificate directly references the prior sale letter, it is essential to give effect to its terms. Hence, it can be concluded that the parties had agreed to

the Bank paying the employees' dues and the subsequent purchaser settling other liabilities, including statutory liabilities. When read in this light, it becomes clear that the sale certificate and the sale letter constitute a contract.

13.3 This brings us to the scheme of distribution of sale proceeds under Section 13(7) of the SARFAESI Act. As mentioned supra, this provision prescribes the manner in which money received by the secured creditor pursuant to its action under Section 13(4) should be distributed. However, such manner of distribution is only applicable *in the absence of a contract to the contrary*. In this case, the sale certificate and sale letter form a contract, the cumulative effect of which is an agreement that only the employees' dues would be settled by the Appellant-Bank, and all other liabilities would be settled by the subsequent purchaser. Thus, it can be said that the contract between the parties diverges from the order of distribution stipulated under Section 13(7) and constitutes *a contract to the contrary*, which must necessarily be given effect.

13.4 In this regard, we find that the clarification given by the Appellant-Bank in its counter-affidavit before the High Court that by the sale letter dated 08.03.2010 it had only accepted liability

towards the payment of provident fund of the employees, is unsustainable. Upon perusing the record, it is clear that this clarification is only a subsequent attempt by the Appellant to escape its liability. If the Appellant genuinely intended to restrict its liability to provident fund, it would have expressly stated so in the sale letter, which clearly prescribes the terms and conditions of the sale between the Appellant and the purchaser. It is important to bear in mind that at the time of entering into this sale, the Appellant-Bank was well aware of the unpaid salaries due to the employees of the Karkhana in view of the orders of the Industrial Court dated 24.08.2006 and 27.04.2007. Hence, it cannot be said that the Appellant-Bank agreed to use the term “employees’ dues” in the sale letter despite intending to limit it to provident fund dues only.

13.5 Thus, on facts, we find that in terms of Section 13(7) of the SARFAESI Act, the distribution of money received by the Appellant-Bank should be done as per the sale contract with Respondent No. 5. In other words, the Appellant-Bank is liable to satisfy the employees’ dues as per its undertaking in the sale letter dated 08.03.2010. However, in view of the fact that all other liabilities, including statutory liabilities were agreed to be borne by

the subsequent purchaser, statutory liabilities *in respect of employees*, such as provident fund, gratuity, bonus etc., would have to be borne by Respondent No. 5 herein. We reiterate here that a subsequent attempt by the Appellant-Bank to interpret the sale contract in a manner that reduces the scope of its liability to provident fund dues cannot be given effect.

14. In view of the foregoing discussion, we summarize our findings as follows:

(i) Section 529A of the Companies Act, which gives workers' dues a priority over all other debts, cannot be applied to the instant case in view of Section 167 of the Societies Act.

(ii) Merely by virtue of being recoverable as arrears of land revenue, the employees' dues, in respect of which a recovery certificate had been issued by the Industrial Court, cannot be treated as a paramount charge in terms of Section 169(1) of the Land Revenue Code. Instead, under 169(2) of the Land Revenue Code, they would take precedence only over unsecured claims.

(iii) At the same time, the Appellant-Bank does not enjoy any paramount charge over the sale proceeds either. Instead, as per Section 13(7) of the SARFAESI Act, the sale letter dated 08.03.2010 and the sale certificate dated 14.09.2010 constitute a

contract which displaces the order of distribution stipulated under the said provision.

(iv) The cumulative effect of these documents is that the Appellant-Bank must pay the employees' dues out of the sale proceeds from the auctioned property. To this extent, the recovery certificate issued by the Industrial Court on 08.08.2011 may be executed against the Appellant herein. Further, given the significant delay in payment of the salaries to the employees, such recovery shall be made by the Collector within a period of six months from the date of this order.

(v) All other dues in respect of the secured property, including any unpaid statutory dues in relation to employees (provident fund, gratuity, bonus, etc.) shall be paid by Respondent No.5 within a period of six months from the date of this order.

15. The instant appeal is disposed of accordingly.

.....**J.**
(MOHAN M. SHANTANAGOUDAR)

.....**J.**
(KRISHNA MURARI)

New Delhi;
December 4, 2019