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*Before Vijender Jain, C.J. & Rajive Bhalla, J.*

S.P. JAIN AND OTHERS,—*Appellants*

*versus*

THE OFFICIAL LIQUIDATOR (UNDER COMPANIES ACT)  
AND OTHERS,—*Respondent*

COMPANY APPEAL NO. 4 OF 2006

IN

COMPANY PETITION NO. 660 OF 2002

IN

COMPANY PETITION NO. 121 OF 1998

18th April, 2007

*Companies Act, 1956—Ss. 520 & 530 (6)—Termination of lease executed in favour of a Company in liquidation by service of a legal notice u/s 106 T.P. Act—Relationship of landlord and tenant in liquidation came to an end—Company Court ordering winding up of company—Assets of company including possession of tenanted premises vested in Company Court—Company Court granting permission to landlord to continue civil suit filed prior to order of liquidation—Civil Court passing decree for possession and mesne profits—Landlord seeking execution of decree before Company Court—Official liquidator seeking time to retain possession of premises so as to enable him to sell assets of company—Retention of premises by official liquidator could not be categorized as possession of premises in ordinary course of debt—Ld. Company Judge erred in holding that as appellants sought permission to continue with suit, their claim for mesne profits would rank as an ordinary debt—Appellant's claim for according priority to mesne profits/rent due to them would partake nature of expenses of liquidation and could not have been categorized as an ordinary debt and would, thus, be entitled to be accorded priority—Matter remitted to Company Judge for proceeding further in accordance with law.*

*Held*, that the official liquidator in the discharge of his duties conferred upon him by the provisions of the Companies Act, 1956 rightly opposed the application for possession by pleading that it was necessary to retain possession of the leased premises so as to enable him to ensure a successful conclusion of the sale of the assets of the

company, without, compromising the rights of the creditors and/or the company in liquidation, in any manner. The official liquidator, thus, put forth an unequivocal plea that it was imperative that he retained possession of the premises for a successful sale of the assets of the company lying stored in the premises. It was necessary for the liquidator to hold possession of leased property, so as to ensure a successful conclusion of the sale of the company's assets and, therefore, the retention of the premises by the official liquidator could, by no stretch of imagination or legal hyperbole, be categorized as possession of the premises in the ordinary course of debt. The appellants' claim would necessarily partake the nature of expenses of liquidation and could not have been categorized as an ordinary debt and would, thus, be entitled to be accorded priority in matters of payment, in accordance with the provisions of Section 520 of the Companies Act, 1956.

(Para 21)

Raj Kumar Gupta, Advocate, *for the appellants.*

Puneet Kansal, Advocate, *for the respondents.*

### JUDGMENT

#### VIJENDER JAIN, C.J.

(1) The appellants herein impugn the order, dated 24th August, 2006, passed by the learned Company Judge, whereby an application, filed for payment of rent/mesne profits, due to the appellants, by according priority, in payment of payment, has been dismissed. In short, the appellants prayed, before the learned Company Judge, that as the amounts, due to them, formed part of liquidation expenses, they were entitled to priority in payments. The appellants have also impugned the order, dated 12th October, 2006, whereby an application for review was dismissed.

(2) The appellants are the owners/land-lords of premises bearing No. 13D, Atma Ram House, 1 Tolstoy Marg, New Delhi. M/S Shree Bhawani Cotton Mills and Industries (company in liquidation) was a tenant in the aforementioned premises at a monthly rent of Rs. 3854.42. On 17th July, 1989, the appellants served a legal notice by registered AD, upon the company, terminating its tenancy and calling upon it to hand over vacant peaceful possession of the

tenanted premises by the mid night of 31st August, 1989. Despite the termination of the lease, the company did not hand over vacant possession of the premises. The appellants, therefore, filed suit No. 982 of 1993, in the Court of Additional District Judge, Delhi. During the pendency of the aforementioned suit, the company was ordered to be wound up,—*vide* order of this Court, dated 15th July, 1999, passed in C.P. No. 121 of 1998. The appellants thereafter filed an application praying for liberty to proceed with the suit. *Vide* order, dated 12th May, 2000, the learned Company Court allowed the said application. On 8th March, 2001, the Additional District Judge, Delhi decreed the suit and passed a decree for possession and mesne profits @ Rs. 25,000 per month with effect from 1st October, 1989 on 26th April, 2001, the appellants filed CP 68 of 2001 for execution of the decree. On 17th August, 2001, the official liquidator prayed that time be granted to enable sale of the assets of the company, where- after, possession of the premises would be delivered to the appellants. Paragraph 2 of the reply, filed by the official liquidator, reads as follows :—

“That the respondent company M/S Shree Bhawani Cotton Mills and Industries Limited (now in liquidation) was maintaining its corporate office in the premises in question i.e. Flat No. 13D, Atma Ram House, 1 Tolstoy Marg, New Delhi-110001. A large number of assets of the aforesaid company are laying at the premises and inventory regarding the same was duly made on 30th August, 2000 in the presence of the representatives of the secured creditors and the ex-director of the company. A copy of the inventory is annexed herewith as Annexure R-1. In the circumstances, it is submitted that until the assets of the company are sold in accordance with law, it is not possible for the official liquidator to hand over the possession of the premises. The official liquidator has no other suitable premises where the goods can be kept and put to sale. In case the possession is handed over now, the assets lying in the premises will go waste or their value will be seriously impaired. Therefore, it is submitted for the kind consideration of this Hon’ble Court that the official liquidator can only vacate the premises after the sale has been carried out. Alternatively, the plaintiffs or their successors may offer to purchase the articles lying in the

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premises after the same are got valued through an approved valuer, in order that the interests of the creditors of the company in liquidation are not harmed.”

(3) The learned Company Court granted four months time to the official liquidator to sell the assets of the company. On 15th December, 2001, the assets, lying in the tenanted premises, were auctioned for a sum of Rs. 52,300. On 29th December, 2001, the official liquidator informed the learned Company Court that the premises had been vacated and *vide* order of even date, the official liquidator was directed to hand over vacant possession of the premises to the appellants. Vacant possession was handed over to the appellants on 29th December, 2001.

(4) On 17th August, 2002, CA No. 660 of 2002 was filed by the appellants *inter alia* pleading therein that as the tenanted premises were occupied by the official liquidator to store assets of the company including the record so as to facilitate the sale of the company's assets, therefore, the sum of Rs. 25,000 per month payable from 15th July, 1999 to 29th December, 2001, partakes the nature of liquidation expenses, in terms of Section 530(6) of the Companies Act, 1956 (for short hereinafter referred to as “the Act”) and should be paid to the appellants, by assigning priority over and above the other creditors.

(5) The official liquidator disputed the *locus standi* of the appellants and contended that the premises in question remained in the custody of the official liquidator in the usual course of office, as the property was not disclaimed. It was asserted that merely because the property remained in the official liquidator's possession, the appellants were not entitled to a preferential payment. All payments, due towards rent, were to be paid to the appellants as unsecured creditors.

(6) The learned Single Judge, after hearing counsel for the parties, and upon an appraisal of the record, placed reliance upon a judgment of the Hon'ble Supreme Court in **Official Liquidators, U.P. Union Bank Ltd. versus Rameswar Nath Aggarwal**, (1) and held that though it was open to the appellants to seek rescission of the contract of tenancy after the order of winding up was passed, they instead sought permission to continue with the suit for possession and,

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(1) AIR 1960 S.C. 332

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therefore, payment of rent for use and occupation of the premises would rank as an ordinary debt, payable on a *pro rata* basis along with other creditors. An application for review of the aforementioned order, filed by the appellants, was dismissed.

(7) Counsel for the appellants contends that the premises in dispute were retained by the official liquidator to bring the liquidation proceedings to a successful conclusion. To substantiate the above contention, reference is made to the reply, filed by the official liquidator to the application seeking execution of the decree for possession. It is contended that as possession was retained by the official liquidator for a successful completion of the sale of assets of the company, the rent/mesne profits payable would necessarily be expenses, incurred in winding up proceedings and the learned Single Judge, therefore, erred in dismissing the application.

(8) It is further argued that the reply, filed by the liquidator, and the order, passed thereon, permitting the liquidator to retain possession of the premises, clearly disclose that possession of the premises was necessary for the liquidator to conclude a successful sale of assets of the company and, therefore, mesne profits payable would necessarily be expenses incurred in winding up proceedings. It is further argued that the learned Company Judge erred in holding that the appellants chose not to rescind the contract. A perusal of the record discloses that the contract of lease executed in favour of the company in liquidation was terminated by issuance of a legal notice, dated 17th July, 1989, served upon the company, in terms of Section 106 of the Transfer of Property Act, prior to initiation of liquidation proceedings. The judgment of the learned Company Judge, being factually incorrect, the conclusions drawn therein are, therefore, erroneous.

(9) It is further contended that the judgment of the Hon'ble Supreme Court in **Official Liquidators, U.P. Union Bank Ltd.'s case** (*supra*), does not oust the appellants claim. The Hon'ble Supreme Court observed on the facts of the said case that as the contract was not rescinded, payments due thereunder would partake the nature of ordinary debts. In the said case, it was specifically held that a distinction was to be drawn between property, which remains in possession of the official liquidator, after winding up for the purpose of liquidation and where property has not been used for the purpose of liquidation. A claim in the former situation would be in the nature of liquidation expenses,

whereas a claim as regards latter, would not be so. Thus, where the property is utilized for the purpose of bringing liquidation proceedings to a successful conclusion, such expenses would partake the nature of liquidation expenses to be assigned priority in matters of payment.

(10) Reliance for the above contentions is placed upon **Board of Trustees for the Port of Kolkata versus Official Liquidator Gauhati High Court and others (2)**, **Income Tax Officer, B-Ward, Companies Circle, Ernakulam versus Official Liquidator, Swaraj Motors (P) Ltd., (3)** and the judgment of this Court, dated 30th May, 2002, passed in C.A. No. 453 of 2002 in C.A. No. 282 of 1999 in C.P. No. 196 of 1997.

(11) Counsel for the respondents, however, contends that as the premises in dispute were merely possessed by the official liquidator and were not retained for the purpose of liquidation of the assets of the company, the amounts claimed by the appellants partake the nature of ordinary debts and cannot be held to be liquidation expenses. It is further argued that the learned Single Judge rightly held that the appellants instead of rescinding the contract, sought permission to proceed with the suit and, therefore, in terms of the judgment of the Hon'ble Supreme Court in **Official Liquidators, U.P. Union Bank Ltd.'s case (supra)**, the claim for mesne profits for use and occupation of the premises leased to the company were rightly held to be an ordinary debt not entitled to any priority in matters of payment. Reliance is also placed upon a judgment of the Delhi High Court in **S.S. Chawla and Company versus Globe Motors Ltd. (in liquidation) and another, (4)**.

(12) We have heard learned counsel for the parties and perused the paper book.

(13) It is not disputed, by either counsel, that normally, claims for rent, against a company in liquidation, are ordinary debts and a landlord raising such claims is an unsecured/ordinary creditor. It is not disputed that where tenanted premises have been used to further the cause of liquidation i.e. to ensure a successful fruition of liquidation proceedings, rent/mesne profits, due on account of user of the premises,

(2) (2006) 130 C.C. 595

(3) 1978 C.C. 14

(4) 1987 Company Cases (Vol. 62) 815 \

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would partake the nature of expenses of liquidation entitling the landlord/lessor to claim priority in the matter of discharge of debts due from the company. The aforementioned would, however, vary and depend upon the facts and circumstances of each case. Thus, a claim, put-forth by a landlord, praying for priority, as regards payment of rent/mesne profits would depend upon the nature to which the property was put to use after liquidation. If the liquidator proceeds to retain the property to ensure a successful fruition of the liquidation proceedings, the claim for rent/mesne profits would partake the nature of "expenses of liquidation" and would, thus, be accorded priority in matters of payment, as regards other creditors of a company.

(14) To fortify the aforementioned conclusion, it would be necessary to make a reference to the judgment of the Hon'ble Supreme Court, also relied upon by the learned Company Judge, though for a different purpose, i.e. **The Official Liquidators, U.P. Union Bank Ltd. (in Liquidation's) case** (*supra*). After examining the question of rescission of a contract in the context of Section 230 of the Companies Act, the Hon'ble Supreme Court went on to hold that a distinction has to be drawn between properties, which remain in the occupation of the liquidator, after winding up for the purpose of liquidation and between occupation by the liquidator merely in normal course. It was held, on facts, that as the liquidator remained in occupation of the premises not for the purpose of winding up, the landlord was not entitled to priority in respect of payment of rent. The relevant extract of the aforementioned judgment reads as follows :—

"7. Distinction has been made by the courts in England where the relevant provisions of the Companies Act are substantially the same that if the liquidator continues in possession of leaseholds for the purpose of the better realization of assets, the lessor will be entitled to payment of the rent in full, as part of the expenses properly incurred by the liquidator; but as observed by Lord Justice Lindley, *In re oak Pits Collier" Co.* (1882) 21 Ch D 322 at p. 331 :

"No authority has yet gone the length of deciding that a landlord is entitled to distrain for or be paid in full rent accruing since the commencement of the winding-up, where the liquidator has done nothing except abstain from trying to get rid of the property which the company holds as lessee."

8. Evidently a distinction is made between property which remains in the occupation of the liquidator after the winding up when the occupation is shown to be for the purpose of liquidation and property which merely remain with the liquidator, he having abstained from trying to get rid of the same and it does not appear or is not shown that the property was used for the purpose of winding up.
9. The High Court held on the facts that the liquidators had remained in occupation of the premises not for the purpose of winding up but because they could not think of any suitable method of getting rid of the premises in spite of all their desire to do so. It was pointed out that the Bank had closed its business and the liquidators were not carrying on any business after the winding up and the properties were not used by the liquidators for the purpose of liquidation. This conclusion of the High Court on the evidence has not been challenged. The property not having remained with the liquidators for the purpose of liquidation, unless the court passes an order holding that the debt incurred was part of the costs and expenses of liquidation, the rent accruing due since the date of the winding up cannot be claimed in priority over other ordinary debts."

(15) It would also be necessary to make a reference to a judgment of the Gauhati High Court in **Board of Trustees for the Post of Kolkata's case** (*supra*). In the aforementioned case, as in the present appeal, the liquidator prayed for liberty to retain possession to enable him to sell the assets of the company. The Gauhati High Court granted permission to the liquidator. Eventually, the lessee raised a dispute that the rent, payable to him, for use and occupation of the premises, during its possession, by the liquidator be accorded priority in payment. The Gauhati High Court held that as it had already permitted the liquidator to retain possession of the premises for a successful conclusion of the liquidation proceedings, the claim of the landlord for rent would have to be accorded priority in payment. It was further held that if possession of the leased property had not been retained by the official liquidator, realization made by way of sale of other assets of the company in liquidation could not have been successfully completed and, therefore, rent payable would necessarily

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have to be construed to be a part of the expenses incurred in winding up proceedings. In **R.K. Manik versus M/S Altos India and others**, C.A. No. 453 of 2002 in C.A. No. 282 of 1999 in C.P. No. 196 of 1997, a Single Bench of this Court held that the landlord was entitled to priority with respect to the payment of mesne profits, due to him, as storage of the company's moveable assets, in their godowns, was necessary to ensure a fair distribution of the sale proceeds of the property of the company in liquidation.

(16) The judgment, cited by counsel for the official liquidator, in **S.S. Chawla and Company's case** (*supra*), in our considered opinion, does not strike a discordant note. After examining the law obtaining with respect to the controversy in hand, it was held as follows :—

“The question, then, is whether, on the facts of the present case, the rents which accrued due, after the winding-up order was made, can be regarded as “the costs and expenses of the winding-up”. The test evolved by the English cases is stated in the following passage in *Palmer's Company Law*, twenty-third edition, at page 1179 :

“The lessor can prove for rent due up to the date of the commencement of the liquidation, and he can also prove for the rent as it accrues due after the commencement of the liquidation. If he seeks to claim that rent accruing after the commencement of the winding up is payable in full, the onus is upon him to show that the liquidator has retained possession of the property for the convenience of the liquidation, so that the rent is payable as an expense of the liquidation, or that a special equity exists justifying the claim of the landlord.

If the liquidator takes possession or continues in possession of lease-holds for the purpose of the better realisation of the assets, the lessor will be entitled to payment of the rent in full as part of the expenses properly incurred by the liquidator.....”

So, what has to be seen is whether possession of the property was taken or retained by the official liquidator “for the convenience of the liquidation” or “for the purpose of better realisation of the assets.”

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(17) Eventually, on facts, it was held that the rent accrued for the user of the godown, after the order of the winding up of the company cannot be treated as part of the costs and expenses of winding up.

(18) The aforementioned judgments, thus, draw up two categories of claims for rent/mesne profits that may be raised with respect to a company in liquidation. Where the liquidator retains possession of the leasehold property to ensure and facilitate a successful fruition of the proceedings of winding up, the claim for mesne profits/rent would necessarily partake the nature of expenses of liquidation and would, thus, have to be accorded priority in matters of payment. Where, however, possession of the premises remains with the liquidator and it does not appear or is not shown that the property was used for the purpose of winding up, the claim for rent/mesne profits would partake the nature of an ordinary debt with no priority being accorded to it in matters of payment. As to the category in which claims for rent/mesne profits fall, would depend upon the facts and circumstances of each case. Onus to establish these facts lies upon the person claiming that the debt forms a part of expenses of liquidation.

(19) In accordance with the legal position, enumerated herein above, we proceed to examine, whether on facts, the appellants succeeded in establishing that the amount due to them were expenses of liquidation.

(20) As is apparent from the record of the present case, the lease, executed in favour of the company in liquidation, stood terminated by service of legal notice, dated 17th July, 1989. This notice issued, under Section 106 of the Transfer of Property Act, determined the lease and the lease no longer subsisted. The relationship of the landlord and the tenant or lessor and lessee between the appellants and the company in liquidation came to an end. The company was ordered to be wound up,—*vide* order dated 15th July, 1999. The assets of the company, including possession of the tenanted premises, vested in the Company Court, as custodian thereof. It is not denied, by counsel for the official liquidator, that prior to the order of liquidation, a suit for possession had been filed

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by the appellants. The appellants sought and were granted permission by the learned Company Court to continue the suit. A decree for possession and mesne profits was passed by the Additional District Judge, Delhi on 8th March, 2001. Thereafter, in response to a petition for execution of the aforementioned decree, filed before the Company Court, the official liquidator, prayed for time to retain possession of the premises so as to enable him to sell the assets of the company, housed in the tenanted premises. The official liquidator specifically pleaded that a large number of assets of the company were lying in the premises and till these assets were not sold, in accordance with law, it was impossible to hand over possession, as no other suitable premises were available. It was also pleaded that in case possession was to be handed over, the assets lying in the premises would go waste or their value would be seriously impaired and the interest of the creditors of the company in liquidation would suffer. On the basis of the aforementioned pleadings, the official liquidator was permitted to retain possession of the premises which were eventually vacated on 29th December, 2001, after the assets of the company were auctioned.

(21) In our considered opinion, the official liquidator, in response to the application for execution, pleaded, in no uncertain terms, that it was necessary for him to retain possession of the premises to ensure a successful fruition of the liquidation proceedings, for otherwise the assets lying in the premises would go waste, and their value would be seriously impaired, thus, adversely affecting the interest of the creditors of the company in liquidation. We are satisfied that the official liquidator, in the discharge of his duties, conferred upon him by the provisions of the Companies Act, 1956, rightly opposed the application for possession, by pleading that it was necessary to retain possession of the leased premises so as to enable him to ensure a successful conclusion of the sale of the assets of the company, without, compromising the rights of the creditors and/or the company in liquidation, in any manner. The official liquidator, thus, put forth an unequivocal plea that it was imperative that he retained possession of the premises, for a successful sale of the assets of the company, lying stored in the premises. It was necessary for the liquidator to hold possession of leased property, so as to ensure

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a successful conclusion of the sale of the company's assets and, therefore, the retention of the premises by the official liquidator could, by no stretch of imagination or legal hyperbole, be categorised as possession of the premises in the ordinary course of debt. The appellants' claim would necessarily partake the nature of expenses of liquidation and could not have been categorised as an ordinary debt, and would thus be entitled to be accorded priority in matters of payment, in accordance with the provisions of Section 520 of the Companies Act, 1956.

(22) The learned Company Judge declined relief to the appellants primarily, by holding that after the company went into liquidation, the appellants, instead of praying for rescission of the contract, prayed for permission to continue with the suit and, therefore, the mesne profits would be an ordinary debt. The learned Company Judge did not notice that the contract of lease stood rescinded as far back as 17th July, 1989, on which date the appellants issued a notice, under Section 106 of the Transfer of Property Act, terminating the lease. The contract of lease stood terminated/rescinded prior to the filing of a petition for winding up and/or passing of the order of winding up. As the contract of lease stood determined, there was no occasion for the appellants to pray for rescission of the contract. A contract that does not subsist cannot be rescinded or terminated and, therefore, the learned Company Judge erred in holding that as the appellants sought permission to continue with the suit, their claim for mesne profits would rank as an ordinary debt.

(23) In view of what has been stated above, we are satisfied that the claim of the appellants for according priority to the mesne profits/rent due to them from 15th July, 1999 to 29th December, 2001 would partake the nature of costs of liquidation/expenses of winding up and would, therefore, have to be accorded priority, in accordance with law. Consequently, the present appeal is allowed, the order dated 24th August, 2006, is set aside and the matter is remitted to the learned Company Judge, for proceeding further, in accordance with law.