THE HON'BLE SRI JUSTICE M.SATYANARAYANA MURTHY

CIVIL MISCELLANEOUS SECOND APPEAL No.31 of 2014

JUDGMENT:

Petitioner in I.P. No.16 of 2009 on the file of I Additional Senior Civil Judge, Kakinada (for short, 'trial court') preferred this appeal questioning the judgment and decree dated 13.08.2013 passed in A.S. No.130 of 2011 on the file of IV Additional District Judge, East Godavari at Kakinada (for short, 'lower appellate court'), whereunder, the lower appellate court, while setting aside the order dated 27.07.2011 in I.P. No.16 of 2009 passed by the trial court, dismissed the insolvency petition.

2. For convenience of reference, the ranks given to the parties in I.P. No.16 of 2009 before the trial Court will be adopted throughout the judgment.

3. The petitioner-creditor (appellant herein) filed the above said insolvency petition under Section 9 of the Provincial Insolvency Act, 1920 (for short, 'the Act') to adjudge the respondent No.1-debtor (respondent No.2 herein) as an insolvent and to annul the sale transaction covered by sale deed dated 02.07.2009 vide document No.3244/2007 at Sub-Registrar's Office, Kakinada, transferring the petition 'A' schedule property. It is alleged by the petitioner that respondent No.1 borrowed a sum of Rs.3,00,000/- from him (petitioner) on 04.07.2008 for his family expenses and for investment in the business, executed a promissory note on the even date agreeing to repay the same together with interest at 24% per annum either to him (petitioner) or to his order as and when demanded. As respondent No.1-debtor failed to discharge the said debt, the petitioner filed O.S. No.560 of 2009 on the file of II Additional Senior Civil Judge, Kakinada, for recovery of the amount due under the said promissory note.

4. While the matter stood thus, respondent No.1-debtor transferred the petition 'A' schedule property to respondent No.2 (respondent No.1 herein) by executing a sale deed dated 02.07.2009 with an intent to defraud and delay the claim of the

petitioner and, thus, committed an act of insolvency. Hence, the petitioner filed the present insolvency petition for the aforesaid reliefs.

5. Respondent No.1-debtor remained *ex parte*.

6. Respondent No.2-purchaser filed counter denying the material allegations including lending of Rs.3,00,000/- by the petitioner to respondent No.1-debtor under the promissory note dated 04.07.2008. Respondent No.2 while contending that she is a *bona fide* purchaser of the petition 'A' schedule property for valuable consideration of Rs.10,00,000/- under registered sale deed dated 02.07.2009 and, thus, she is entitled for protection and that the transaction covered by the said sale deed cannot be annulled, prayed for dismissal of the petition.

7. During the course of enquiry, on behalf of the petitioner, P.Ws.1 and 2 were examined and Exs.A.1 to A.4 were marked; whereas, on behalf of respondent No.2, her husband was examined as R.W.1 and Exs.B.1 to B.4 were marked.

8. Upon hearing argument of both the learned counsel and considering the oral and documentary evidence on record, the trial court adjudged respondent No.1-debtor as an insolvent while annulling the transaction covered by original of Ex.A.1-sale deed.

9. Aggrieved by the order and decretal order passed by the trial court, respondent No.2-purchaser filed appeal before the lower appellate court and the same was allowed on 13.08.2013 reversing the decree and decretal order passed by the trial court.

10. Aggrieved by the decree and judgment dated 13.08.2013 in A.S. No.130 of 2011 passed by the lower appellate court, the present Civil Miscellaneous Second Appeal is preferred by the petitioner-creditor raising several contentions. In the grounds of appeal, learned counsel for the petitioner-creditor raised four substantial questions of law. Out of which, second substantial question law is only

relevant for the purpose of deciding the present appeal.

11. Sri N. Siva Reddy, learned counsel for the petitioner-creditor, contended that the scope of enquiry in a petition filed under Section 9 of the Act is limited, therefore, the Court is at best, to decide whether the act complained against respondent No.1-debtor amounts to an act of insolvency within the scope of Section 6 of the Act or not, but the Court is not supposed to record a finding that respondent No.2 is a *bona fide* purchaser, while deciding a petition under Section 9 of the Act, and therefore, the finding recorded by the trial court is erroneous and it is beyond the scope of the enquiry in a petition filed under Section 9 of the Act, and hence, prayed to set aside the same.

12. Whereas, Sri S.Subba Reddy, learned counsel for respondent No.2-purchaser (respondent No.1 herein), would contend that the transaction covered by original of Ex.A.1 is protected under Section 55 of the Act and supported the decree and judgment of the lower appellate court and prayed to dismiss the appeal.

13. Considering the facts and circumstances of the case and the argument advanced by both the learned counsel, the substantial question of law that arises for consideration is:

> **"Whether the Court, exercising jurisdiction under the Provincial Insolvency Act, 1920, is competent to decide as to whether the transaction covered by original of Ex.A.1 is a *bona fide* transaction, while adjudging respondent No.1-debtor (respondent No.2 herein) as insolvent? If not, the order passed by the lower appellate court be sustained?"**

14. **<u>POINT</u>:**

Admittedly, the trial court while adjudging respondent No.1-debtor as insolvent, annulled the transaction covered by original of Ex.A.1, but the scope of enquiry in a petition filed under Section 9 of the Act is limited and, at best, the Court is supposed to record a finding whether respondent No.1-debtor committed any act of insolvency within the meaning of Section 6 of the Act, subject to satisfying the conditions under Section 9 of the Act. But, contrary to the scope of enquiry, the trial court annulled the transaction covered by original of Ex.A.1 and it is, *ex facie*, erroneous for the reason that the order of annulment of the transaction covered by original of Ex.A.1 cannot be passed simultaneously while adjudging respondent No.1-debtor as insolvent.

15. To decide the real controversy between the parties, I feel that it is relevant to advert to the provisions of the Act, more particularly, Sections 53, 54 and 54A of the Act. Section 53 of the Act says that any voluntary transfer made by the debtor if the transferor is adjudged as insolvent can be avoided and at the same time, Section 54 of the Act says that every transfer of property, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any person unable to pay his debts as he become due from his own money in favour of any creditor, with a view of giving that creditor a preference over the other creditors, shall, if such person is adjudged as insolvent on a petition presented within three months after the date thereof, be deemed fraudulent and void as against the receiver, and shall be annulled by Court holding that the transaction entered into is not in good faith and for valuable consideration.

16. A fraudulent transfer under Section 53 of the Act and the transaction to give fraudulent preference under Section 54 of the Act are void against the receiver and they shall be annulled on the petition filed within specific time. Section 54A of the Act specifies procedure for annulment of any transfer under Sections 53 and 54 of the Act. According to Section 54 of the Act, for annulment of any transfer under Sections 53 or 54 of the Act, a petition may be presented by the receiver, with the leave of the Court, by any creditor who has proved his debt and who satisfies the Court that the receiver has been requested and has refused to make such petition.

17. In view of the language used in Sections 53 and 54 of the Act, more particularly, the words “if the transferor is adjudged insolvent” under Section 53 of the Act and “if the person is adjudged insolvent” under Section 54 of the Act indicates that for annulling transaction of transfer, the debtor must be an adjudged insolvent. So, to annul a transaction of transfer, a pre-condition is adjudging the debtor as an insolvent. But, here the petition was filed by the creditor seeking two

reliefs both under Section 9 and Sections 53 and 54 of the Act to avoid a fraudulent preference and annul the transactions covered by the original of Ex.A.1 sale deed. Thus, he sought for two reliefs simultaneously and the relief claimed by the petitioner-creditor is against the spirit of language used under Sections 53, 54 and 54A of the Act.

18. As per Section 54A of the Act, it is clear that before moving the Court for annulment of transfer, more particularly, covered by sale deed Ex.A.1, it is the duty of the petitioner to prove his debts before the Official Receiver as required under Section 49 of the Act and then move the Court exercising insolvency jurisdiction for annulling transfer, if receiver refuses to make such petition for annulment on the request made by the creditor. So, even according to Section 54A of the Act, it is the duty of the creditor to prove the debt before the Official Receiver.

19. Section 49 of the Act specifies the procedure to be followed for proof of debt. According to it, a debt may be proved under this Act by delivering, or sending by post in a registered letter, to the Court an affidavit verifying the debt. The affidavit shall contain or refer to a statement of account showing particulars of the debt, and shall specify the vouchers by which the same can be substantiated by the Court at any time and call for production of vouchers. Therefore, the debt shall be proved by following necessary procedure contemplated under Section 49 of the Act after entrusting the matter to Official Receiver duly adjudging the debtor as insolvent.

20. Part-III of the Act from Sections 45 to 50 laid down procedure for proof of debts. Following of such procedure under Sections 45 to 50 of the Act, would arise only after adjudging the debtor as insolvent. But here, the relief under Sections 53, 54 of the Act was claimed simultaneously with the relief of adjudging the debtor as insolvent. The conditions laid down under Section 54A of the Act were not complied by the petitioner to get the transaction covered by the original of Ex.A.1 annulled. A perusal of language used under Sections 53, 54 and 54A of the Act and the mode of proof of debt under Part-III of the Act (from Sections 45 to 50), it is clear that before moving an insolvency Court to annul transfer of property, a creditor has to satisfy the following conditions:

(1) The debtor must be adjudged as insolvent;

(2) The creditor should prove his debt by following the procedure contemplated under Part-III of the Act; (3) He should have made a request to the Official Receiver for moving insolvency Court for annulling fraudulent transaction and that the Official Receiver refused to move such petition for annulment.

21. In the instant case, by the date of filing petition, seeking annulment under Sections 53 or 54 of the Act, the debtor was not even adjudged as insolvent. So, the first condition was not satisfied. The petitioner did not approach the Official Receiver and proved his debt as contemplated under Part-III of the Act and complied Section 54A of the Act. Thereby, the judgment of the lower appellate court to the extent of setting aside the annulment of transaction covered by original of Ex.A.1 is upheld, since it is contrary to the procedure laid down under the Act. However, setting aside the entire order of the trial court by the lower appellate court including adjudging respondent No.1-debtor is without any legal reasoning. Therefore, to the extent of setting aside the annulment of transaction covered by original of Ex.A.1, the judgment of the lower appellate court is confirmed giving liberty to the petitioner-creditor to move an application for annulling the transaction covered by original of Ex.A.1 following due procedure referred in the earlier paragraphs.

22. The only endeavour of the learned counsel for respondent No.2-purchaser is that she is entitled to protection under Section 55 of the Act, as she is a *bona fide* purchaser for valuable consideration. No doubt, such *bona fide* purchasers are protected, but it is subject to proof of *bona fides* on the part of respondent No.2-purchaser and it is a question of fact to be established during enquiry before the competent court. The question of proving that respondent No.2-purchaser is a *bona fide* purchaser would arises only in an application filed under Sections 53 and 54 by following procedure under Section 54A of the Act. Till then, respondent No.2-purchaser is not required to prove that she is a *bona fide* purchaser for a valuable consideration. But the lower appellate court, on misconception, concluded that respondent No.2 is a *bona fide* purchaser for valuable consideration

and the finding of the trial court is premature. However, in case the petitioner-creditor or Official Receiver files any application under Sections 53 or 54 of the Act for annulment of transaction covered by original of Ex.A.1, respondent No.2-purchaser is at liberty to raise specific plea that she is a *bona fide* purchaser for valuable consideration.

23. Giving the aforesaid liberty to both the petitioner-creditor and respondent No.2-purchaser, the present Civil Miscellaneous Second Appeal is allowed in part confirming the judgment and decree dated 13.08.2013 in A.S. No.130 of 2011 passed by the lower appellate court to the extent of setting aside the annulment of transaction covered by original of Ex.A.1, while setting aside the finding of the lower appellate court to the extent of setting aside the finding of the trial court in adjudging respondent No.1-debtor as an insolvent. However, the observations or finding recorded in this appeal will have no bearing in the collateral proceedings arising out of the insolvency proceedings. There shall be no order as to costs.

24. As a sequel thereto, miscellaneous petitions, if any pending in this appeal, shall stand closed.

M.SATYANARAYANA MURTHY, J.

Date: 15-09-2015

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