

THE STOCK EXCHANGE, BOMBAY

v.

V. S. KANDALGAONKAR & ORS.

(Civil Appeal No. 4354 of 2003)

SEPTEMBER 25, 2014

(R. M. LODHA, CJI, KURIAN JOSEPH AND  
R. F. NARIMAN, JJ.)

*Income Tax Act, 1961:*

*s.226(3) – Assessee in default of income tax – Such assessee, also declared a defaulter member of Stock Exchange – Priority over debts owed by defaulter member to Stock Exchange and Income Tax Department – Held: Membership card is only a personal permission from Stock Exchange to exercise the rights and privileges that may be given subject to Rules, Bye-Laws and Regulations of Stock Exchange — Therefore, the proceeds of a membership card cannot be paid over to Income Tax Department for the dues of the members – As regards securities deposited with Stock Exchange, the lien possessed by Stock Exchange makes it a secured creditor and, as such, it would have priority over Government dues – Provincial Insolvency Act, 1920 – s.2(e) – Securities and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 – s.2(zf) – Constitution of India, 1950 – Art. 372 – Securities Contracts (Regulation) Act, 1956 – ss. 8 and 9 – Rules framed under – rr. 5, 9, 16(iii) and 43 – Subordinate legislation.*

**Allowing the appeal, the Court**

**HELD : 1.1 In view of Rules 5 and 9 of the Rules framed under the Securities Contracts (Regulation) Act, 1956, a membership card is only a personal permission from the Stock Exchange to exercise the rights and privileges that may be given subject to Rules, Bye-Laws and Regulations of the Exchange. Further, the moment**

- A a member is declared a defaulter, his right of nomination shall cease and vest in the Exchange because even the personal privilege given is, at that point, taken away from the defaulting member. Therefore, the proceeds of a membership card cannot be paid over to Income Tax Department for the dues of the members by virtue of r.16 (iii), as such a member at no point of time owns any property capable of attachment. [Para 14 and 17] [434-F-H; 438-C-E]

- C *Isha Valimohamad and Anr. v. Haji Gulam Mohamad & Haji Dada Trust* 1975 (1) SCR 720; *Stock Exchange, Ahmedabad v. Asstt. Commisioner of Income Tax, Ahmedabad* 2001 (2) SCR 255 = 2001 (3) SCC 559 – relied on.

- D 2. The expression “transfer” can depending upon its context mean transfer of ownership or transfer of possession. As regards the securities deposited by the member with the Stock Exchange, it is clear that what is transferred is only possession as the member only “deposits” these securities. [Para 17][439-E-G]

- E *Vasudev Ramchandra Shelat v. Pranalal Jayanand Thakur & Ors.*, 1975 (2) SCR 534; *Bombay Stock Exchange v. Jaya Shah* 2003 (4) Suppl. SCR 892 = 2004 (1) SCC 160 – relied on.

- F 3.1 It is settled law that Government debts have precedence only over unsecured creditors. The moment the Stock Exchange has a lien over the member’s securities, it would have precedence over income tax dues. [Para 19][444-F-G; 445-F-G]

- G *Dena Bank v. Bhikabhai Prabhudas Parekh Co.* 2000 (3) SCR 509 = 2000 (5) SCC 694 – relied on

*Triveni Shankar Saxena v. State of U.P. & Ors.* 1991 (3) Suppl. SCR 534 = 1992 Suppl. 1 SCC 524; *K.S. Saradambal v. Jagannatham K Brothers*, (1972) 42 Companies Case 359 – referred to.

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3.2 In the instant case, the first and paramount lien given to the Stock Exchange is by Rule 43 of the Rules made u/s 8 of the Securities Contract (Regulations) Act. Rules made by Stock Exchanges in exercise of powers conferred by the Securities Contracts (Regulation) Act are equally “Rules” and, therefore, subordinate legislation. Therefore, the lien spoken of by Rule 43 is a lien, conferred by Rules under a statute. [Para 21] [451-D-F]

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*Forwarding P. Ltd. and another v. Trustees, Port of Vizagapatnam, and Anr.*, (1987) 61 Company Cases 513; *Board of Trustees, Bombay v. Indian Oil Corporation* 1998 (2) SCR 774 = 1998 (4) SCC 302 – referred to.

D

3.3 Income Tax Act does not provide for any paramountcy of dues by way of income tax. In the instant case, the common law of England qua Crown debts became applicable by virtue of Art. 372 of the Constitution which states that all laws in force in the territory of India immediately before the commencement of the Constitution shall continue in force until altered or repealed by a competent legislature or other competent authority. The lien possessed by the Stock Exchange makes it a secured creditor and, as such, it would have priority over Government dues. [Para 24-25] [454-D-F; 455-A-B]

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*Collector of Aurangabad and Anr. v. Central Bank of India and Anr.* 1967 (3) SCR 855; *Giles v. Grover* (1832) (131) English Reports 563 – relied on.

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**CASE LAW REFERENCE**

2001 (2) SCR 255                      relied on              para 11

2000 (3) SCR 509                      relied on              para 17

1975 (2) SCR 534                      relied on              para 17

B 2003 (4) Suppl. SCR 892              relied on              para 17

2000 (3) SCR 509                      relied on              para 19

1991 (3) Suppl. SCR 534              referred to              para 19

(1972) 42 Companies Case 359 referred to              para 19

C (1987) 61 Company Cases 513 referred to              para 22

1998 (2) SCR 774                      referred to              para 22

(1832) (131) English Reports 563 referred to              para 24

1967 (3) SCR 855                      referred to              para 24

CIVIL APPELLATE JURISDICTION : Civil Appeal No.

D 4354 of 2003.

From the judgment and order dated 27.03.2003 in W.P. No. 220 of 1997 passed by the Division Bench of the High Court at Bombay.

E Arvind P. Datar, Sr. Adv., Pratap Venugopal and Surekha Raman (For M/s. K.J. John & Co.), Advocates for the Appellant.

R.P. Bhatt, Sr. Adv., Arijit Prasad, Vikas Malhotra, Ms. Sriparna Chatterjee, Wasim A. Qadri, Ms. Anil Katiyar, B.V. Balramdas, Bhargava V. Desai and Archana, Advocates

F for the Respondents.

The Judgment of the Court was delivered by

**R. F. NARIMAN, J.**

G 1. The present matter arises as the result of a member of a Stock Exchange being declared a defaulter. The Income Tax Department claims that it has priority over all debts owed by the defaulter member, whereas the Stock Exchange, Bombay claims otherwise.

H 2. The facts necessary to appreciate the controversy are as follows :

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By a notice dated 29th June 1994, the Stock Exchange, Bombay declared Shri Suresh Damji Shah as a defaulter with immediate effect as he had failed to meet his obligations and discharge his liabilities. By a notice dated 5th October 1995 issued under Section 226 (3) of the Income Tax Act, the Income Tax Department wrote to the Stock Exchange and told them that Shri Shah's membership card being liable to be auctioned, the amount realized at such auction should be paid towards Income Tax dues of Assessment Year 1989-90 and 1990-91 amounting to Rs.25.43 Lakhs. The Stock Exchange, Bombay by its letter dated 11th October 1995 replied to the said notice and stated that under Rules 5 and 6 of the Stock Exchange the membership right is a personal privilege and is inalienable. Further, under Rule 9 on death or default of a member his right of nomination shall cease and vest in the Exchange and accordingly the membership right of Shri Shah has vested with the Exchange on his being declared a defaulter. This being the case, since the Exchange is now and has always been the owner of the membership card, no amount of tax arrears of Shri Shah are payable by it. By a prohibitory order dated 10th May 1996, the Income Tax Department prohibited and restrained the Stock Exchange from making any payment relating to Shri Shah to any person whomsoever otherwise than to the Income Tax Department. The amount claimed in the prohibitory order was stated to be Rs. 37.48 Lakh plus interest. On 18th July 1996, the Solicitors of the Stock Exchange, Bombay wrote to the Income Tax Department calling upon them to withdraw the prohibitory order dated 10th May 1996 in view of the fact that the membership right of the Exchange is a personal privilege and is inalienable. By a letter dated 27th December 1996, the Tax Department wrote back to the Bombay Stock Exchange refusing to recall its prohibitory order. Meanwhile, Shri Shah applied to be re-admitted to the Stock Exchange which application was rejected by the Stock Exchange on 13th February, 1997.

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A        3. The Stock Exchange then filed a Writ Petition being Writ Petition No.220 of 1997 dated 24th December 1996 in which the following reliefs were claimed:

B            (a)    that this Hon'ble Court may be pleased to issue a writ of certiorari or a writ in the nature of certiorari or any other appropriate writ, order or direction under Article 226 of the Constitution of India calling for the records in relation to the recovery proceedings initiated by the Respondents against Mr. Suresh D. Shah and after going through the same and examining the legality and validity thereof to quash and set aside the impugned notice dated 5th October, 1995 and the impugned order dated 10th May 1996, Impugned Notice/ letter dated 27th December 1996 being Exhibits "D", "F" and "H" hereto;

D            (b)    that this Hon'ble Court may be pleased to issue a writ of mandamus or any other appropriate writ, order or direction under Article 226 of the Constitution of India ordering and directing the Respondents to withdraw forthwith the recovery proceedings initiated against in respect of the dues of Mr Suresh D. Shah and ordering and directing the Respondents to withdraw forthwith the impugned notice dated 5th October, 1995 and the impugned notice dated 5th October, 1995 and the impugned prohibitory Order dated 10th May, 1996, Impugned Notice/letter dated 27th December 1996 being Exhibits "D", "F" and "H" hereto;

E            (c)    that this Hon'ble Court be pleased to permit the Petitioner to exercise the right of nomination in respect of the membership right of Suresh D. Shah in favour of such person as the petitioner may decide and to apply the consideration received therefore and also appropriate all other securities

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placed with the Petitioner by Suresh d. Shah and which have vested in the Petitioner in accordance with the Rules, Bye-laws and regulations of the Petitioner;

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4. The Writ Petition was finally heard and by a judgment dated 27th March 2003, most of the contentions of the Stock Exchange were rejected and the Writ Petition was dismissed.

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5. A Special Leave Petition was filed against the said judgment being SLP(Civil) No. 8245 of 2003 in which, by an order dated 7th May 2003, the operation of the judgment was not stayed to the extent that it specifically directed the petitioner to make certain payments and handover securities to the Income Tax Department. However, in so far as the judgment declared law, the operation of such declaration of law was stayed.

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6. As this Civil Appeal raises important questions of law both from the point of view of the Bombay Stock Exchange and the Income Tax Department, we are going into the matter in some detail.

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7. Section 226 of the Income Tax Act provides for a garnishee notice in the following terms:

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*"Section 226 3(i) The assessing officer or tax recovery officer may, at any time or from time to time, by notice in writing require any person from whom money is due or may become due to the assessee or any person who holds or may subsequently hold money for or on account of the assessee, to pay the assessing officer or tax recovery officer either forthwith upon the money becoming due or being held or at or within the time specified in the notice (not being before the money becomes due or is held) so much of the money as is sufficient to pay the amount due by the assessee in respect of arrears or the whole of the money when it is equal to or less than that amount."*

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- A Under Sub-section (x), if the person to whom a notice is sent fails to make payment in pursuance thereof he shall be deemed to an assessee in default. Rule 26 of Schedule II of the Income Tax Act then provides:
- B "26. Debts and Shares, etc. — (1) In case of—
- a) a debt not secured by a negotiable instrument,
- b) a share in a corporation, or
- C c) other movable property not in the possession of the defaulter except property deposited in, or in the custody of, any court, the attachment shall be made by a written order prohibiting, —
- (i) in the case of the debt — the creditor from recovering the debt and the debtor from making payment thereof until the further order of the tax recovery officer;
- D (ii) in the case of the share — the person in whose name the share maybe standing from transferring the same or receiving any dividend thereon;
- E (iii) in the case of the other movable property (except as aforesaid) — the person in possession of the same from giving it over to the defaulter.
- F (2) A copy of such order shall be affixed on some conspicuous part of the office of the tax recovery officer, and another copy shall be sent, in the case of the debt, to the debtor, in the case of the share, to proper officer of the corporation, and
- G in the case of the other movable property (except as aforesaid), to the person in possession of the same.
- (3) A debtor prohibited under clause (i) of sub-rule (1) may pay the amount of his debt to the tax recovery officer, and such payment shall
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discharge him as effectually as payment to the party entitled to receive the same.” A

Sections 8 and 9 of the Securities Regulation Act, 1956 deal with Rules, Regulations and Bye-Laws to be made in respect of Stock Exchanges. Sections 8 and 9 of the said Act read as follows: B

“8. Power of Central Government to direct rules to be made or to make rules-

(1) Where, after consultation with the governing bodies of stock exchanges generally or with the governing body of any stock exchange in particular, the Central Government is of opinion that it is necessary or expedient so to do, it may, by order in writing, together with a statement of the reasons therefore, direct recognised stock exchanges generally or any recognised stock exchange in particular, as the case may be, to make any rules or to amend any rules already made in respect of all or any of the matters specified in sub-section (2) of section 3 within a period of two months from the date of the order. C D E

(2) If any recognised stock exchange fails or neglects to comply with any order made under sub-section (1) within the period specified therein, the Central Government may make the rules for, or amend the rules made by, the recognised stock exchange, either in the form proposed in the order or with such modifications thereof as may be agreed to between the stock exchange and the Central Government. F

(3) Where in pursuance of this section any rules have been made or amended, the rules so made or amended shall be published in the Gazette of India and also in the Official Gazette or Gazettes of the State or States in which the principal office or offices of the recognised stock exchange or exchanges is or are situate, and, on the publication thereof in the Gazette of India, the rules so H

A made or amended shall, notwithstanding anything to the contrary contained in the Companies Act, 1956 (I of 1956), or in any other law for the time being in force, have effect, as if they had been made or amended by the recognised stock exchange or stock exchanges, as the case may be.

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9. Power of recognised stock exchanges to make bye-laws.-

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(1) Any recognised stock exchange may, subject to the previous approval of the Securities and Exchange Board of India, make bye-laws for the regulation and control of contracts.

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(2) In particular, and without prejudice to the generality of the foregoing power, such bye-laws may provide for—

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(a) the opening and closing of markets and the regulation of the hours of trade;

(b) a clearing house for the periodical settlement of contracts and differences thereunder, the delivery of and payment for securities, the passing on of delivery orders and the regulation and maintenance of such clearing house;

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(c) the submission to the Securities and Exchange Board of India by the clearing house as soon as may be after each periodical settlement of all or any of the following particulars as the Securities and Exchange Board of India may, from time to time, require, namely;—

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(i) the total number of each category of security carried over from one settlement period to another;

(ii) the total number of each category of security, contracts in respect of which have been squared up during the course of each settlement period;

(iii) the total number of each category of security actually delivered at each clearing;

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(d) the publication by the clearing house of all or any of the particulars submitted to the Securities and Exchange Board of India under clause (c) subject to the directions, if any, issued by the Securities and Exchange Board of India in this behalf; A

(e) the regulation or prohibition of blank transfers; B

(f) the number and classes of contracts in respect of which settlements shall be made or differences paid through the clearing house;

(g) the regulation, or prohibition of bundles or carry-over facilities; C

(h) the fixing, altering or postponing of days for settlements;

(i) the determination and declaration of market rates, including the opening, closing, highest and lowest rates for securities; D

(j) the terms, conditions and incidents of contracts, including the prescription of margin requirements, if any, and conditions relating thereto, and the forms of contracts in writing; E

(k) the regulation of the entering into, making, performance, rescission and termination, of contracts, including contracts between members or between a member and his constituent or between a member and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer, and the responsibility of members who are not parties to such contracts; F

(l) the regulation of taravani business including the placing of limitations thereon; G

(m) the listing of securities on the stock exchange, the inclusion of any security for the purpose of dealings and the suspension or withdrawal of any such securities, and H

- A the suspension or prohibition of trading in any specified securities;
- (n) the method and procedure for the settlement of claims or disputes, including settlement by arbitration;
- B (o) the levy and recovery of fees, fines and penalties;
- (p) the regulation of the course of business between parties to contracts in any capacity;
- (q) the fixing of a scale of brokerage and other chargers;
- C (r) the making, comparing, settling and closing of bargains;
- (s) the emergencies in trade which may arise, whether as a result of pool or syndicated operations or cornering or otherwise, and the exercise of powers in such emergencies, including the power to fix maximum and minimum prices for securities;
- D (t) the regulation of dealings by members for their own account;
- (u) the separation of the functions of the jobbers and brokers;
- E (v) the limitations on the volume of trade done by any individual member in exceptional circumstances;
- (w) the obligation of members to supply such information or explanation and to produce such documents relating to the business as the governing body may require.
- F (3) The bye-laws made under this section may—
- (a) specify the bye-laws the contravention of which shall make a contract entered into otherwise than in accordance with the bye-laws void under sub-section (1) of section 14;
- G (b) provide that the contravention of any of the bye-laws shall render the member concerned liable to one or more of the following punishments, namely:—
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(i) fine;

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(ii) expulsion from membership;

(iii) suspension from membership for a specified period;

(iv) any other penalty of a like nature not involving the payment of money.

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(4) Any bye-laws made under this section shall be subject to such conditions in regard to previous publication as may be prescribed, and when approved by the Securities and Exchange Board of India, shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognised stock exchange is situate, and shall have effect as from the date of its publication in the Gazette of India;

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Provided that if the Securities and Exchange Board of India is satisfied in any case that in the interest of the trade or in the public interest any bye-law should be made immediately, it may, by order in writing specifying the reasons therefore, dispense with the condition of previous publication."

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8. As a number of rules of the Stock Exchange have been referred to in the course of argument, we will set down those which are relevant for the purposes of the question to be decided.

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"Membership a Personal Privilege

5. The membership shall constitute a personal permission from the Exchange to exercise the rights and privileges attached thereto subject to the Rules, Bye-laws and Regulations of the Exchange.

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Right of Nomination

7. Subject to the provisions of these Rules a member shall have the right of nomination which shall be, personal and non-transferable.

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A      Right of Nomination of Deceased or Defaulter Member

9. On the death or default of a member his right of nomination shall cease and vest in the Exchange.

Forfeited or Lapsed Right of Membership

B      10. When a right of membership is forfeited to or vests  
C      in the Exchange under any Rule, Bye-law or Regulation  
of the Exchange for the time being in force it shall belong  
absolutely to the Exchange free of all rights, claims or  
interest of such member or any person claiming through  
such member and the Governing Board shall be entitled  
to deal with or dispose of such right of membership as it  
may think fit.

Allocation in Order of Priority

D      16. When as provided in these Rules the Governing Board  
has exercised the right of nomination in respect of a  
membership vesting in the Exchange the consideration  
received therefore shall be applied to the following  
purposes and in the following order of priority namely -

E      Dues of Exchange and Clearing House

F      i. first-the payment of such subscriptions, debts, fines,  
fees, charges and other monies as shall have been  
determined by the Governing Board to be due to the  
Exchange, to the Clearing House by the former  
member whose right of membership vests in the  
Exchange.

Liabilities relating to Contracts

G      ii. second-the payment of such debts, liabilities,  
obligations and claims arising out of any contracts  
made by such former member subject to the Rules,  
Bye-laws and Regulations of the Exchange as shall  
have been admitted by the Governing Board:

H      • Provided that if the amount available be insufficient to  
pay and satisfy all such debts, liabilities, obligations

and claims in full they shall be paid and satisfied pro rata; and A

Surplus

iii. third-the payment of the surplus if any to the funds of the Exchange: provided that the Exchange in general meeting may at its absolute discretion direct that such surplus be disposed of or applied in such other manner as it may deem fit. B

37. Form of Security

The security to be furnished by a member shall be provided either by a deposit of cash or it may be provided in the form of a Deposit Receipt of a Bank approved by the Governing Board or in Securities approved by the Governing Board subject to such terms and conditions as the Governing Board may from time to time impose. Deposits of cash shall not carry interest and the securities deposited by a member valued at the market price of the day shall exceed the sum for the time being secured thereby by such percentage as the Governing Board may from time to time prescribe. C D E

38. Security How Held

Deposits of cash shall be lodged in a Bank approved by the Governing Board and Bank Deposit Receipts and securities shall be transferred to and held either in the names of the Trustees of the Exchange or in the name of a Bank approved by the Governing Board and lodged with a Bank approved by the Governing Board. Such deposit shall be entirely at the risk of the member providing the security but it shall be held by the Bank solely for and on account of the Exchange at the absolute discretion of the Exchange without any right whatever on the part of such member or those in his right to call in question, the exercise of such discretion. F G

A      Change of Security

41. A member may withdraw any security provided by him if he first provides in lieu thereof other security of sufficient value to the satisfaction of the Governing Board.

B      Lien on Security

43. The security provided by a member shall be subject to a first and paramount lien for any sum due to the Exchange or to the Clearing House by him or by the partnership of which he may be a member and for the due fulfillment of his engagements, obligations and liabilities or of the partnership of which he may be a member arising out of or incidental to any bargains, dealings, transactions and contracts made subject to the Rules, Bye-laws and Regulations of the Exchange or anything done in pursuance thereof.

D      Return of Security

44. On the termination of his membership or on his ceasing to carry on business on the Exchange or on his working as a representative member or on his death all security not applied under the Rules, Bye-laws and Regulations of the Exchange shall at the cost of the member be repaid and transferred either to him or as he shall direct or in the absence of such direction to his legal representatives.

F      Letter of Declaration

46. A member providing security under the provisions of these Rules shall sign a Letter of Declaration in the form prescribed in Appendix F to these Rules or in such other form as the Governing Board may from time to time prescribe.

APPENDIX F

Member's Security Declaration Form No. 1

(Rule 46)

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The Governing Board,  
The Stock Exchange,  
Bombay.

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Gentlemen,

Having been admitted as a member of the Stock  
Exchange and having handed to you in terms of the Rules  
thereof to be deposited in

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\_\_\_\_\_ (Name of Bank) in the name

of the Exchange the sum of Rs. 20,000 and/or having  
transferred to the names of the Trustees of the Exchange  
and/or (Name of Bank) the securities mentioned below,

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I hereby declare and agree that the said Security and  
any cash, stock, shares or other securities that may be  
added to or substituted for the said Security by  
arrangement with you are subject to a first and paramount  
lien for any sum due to the Exchange or to the Clearing  
House by me/us or by the partnership of which I may be  
a partner and for any sum due to any member of the  
Exchange for the due fulfillment of my engagements,

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obligations and liabilities or of the partnership of which I  
may be a member arising out of or incidental to any  
bargains, dealings, transactions and contracts made  
subject to the Rules, Bye-laws and Regulations of the  
Exchange or anything done in pursuance thereof. I hereby

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further declare and agree that the said Security and any  
cash, stock, shares or other securities that may be added  
to or substituted for the said Security by arrangement  
with you are to be held for you and on your account by  
the said Trustees and/or Bank(s) at your absolute  
discretion without any right whatever on the part of myself

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or those in my right to call in question the exercise of  
such discretion on any ground whatever so that you may  
at your absolute discretion as aforesaid apply and pay  
the same or the proceeds thereof (in case you shall as  
you shall be fully entitled to do sell the same) or cause  
the same to be applied and paid to or for behalf of the

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- A Exchange or the Clearing House to whom I or any partnership of which I may be a partner may be indebted or to or for behalf of any member of the Exchange to whom I or any partnership of which I may be a partner may be indebted under a claim or claims arising from
- B any bargains, dealings, transactions and contracts made subject to the Rules, Bye-laws and Regulations of the Exchange during the continuance of my membership of the Exchange. If on the completion of all bargains, dealings, transactions and contracts entered into before
- C the termination of my membership or on my ceasing to do business on the Exchange the said Security or proceeds thereof shall not have been required for payment of my or my said partnership liabilities as above provided the same or any balance thereof then remaining
- D will be returned to me and a receipt signed by me that whatever cash, stock, shares or other securities or balance thereof is/are so returned to me is/are all to which I am entitled in terms hereof shall be final and conclusive and bar inquiry of any kind at the instance of
- E myself or any one in my right in respect thereof.

Yours faithfully,

(Signature of member depositing the Security)

Securities above referred to:

- F Some bye-laws of the Stock Exchange are also relevant. These are:

Defaulter's Assets

- G 326. The Defaulters' Committee shall call in and realise the security and margin money and securities deposited by the defaulter and recover all monies, securities and other assets due, payable or deliverable to the defaulter by any other member in respect of any transaction or dealing made subject to the Rules, Bye-laws and Regulations of the Exchange and such assets shall vest
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in the Defaulters' Committee for the benefit and on A  
account of the creditor members.

Payment to Defaulters' Committee

327. All monies, securities and other assets due, payable B  
or deliverable to the defaulter must be paid or delivered  
to the Defaulters' Committee within such time of the  
declaration of default as the Governing Board or the  
President may direct. A member violating this provision  
shall be declared a defaulter.

Distribution

330. The Defaulters' Committee shall at the risk and cost C  
of the creditor members pay all assets received in the  
course of realisation into such bank and/or keep them  
with the Clearing House in such names as the Governing D  
Board may from time to time direct and shall distribute  
the same as soon as possible pro rata upto sixteen annas  
in the Rupee but without interest among the creditor  
members whose claims are admitted in accordance with  
these Bye-laws and Regulations.

Application of Defaulters' Assets and Other Amounts

400. Subject to the provisions of Bye-law 398, the E  
Defaulters' Committee shall realise and apply all the  
money, rights and assets of the defaulter which have  
vested in or which have been received by the Defaulters' F  
Committee (other than the amount paid by the Governing  
Board to the Defaulters' Committee pursuant to Rule 16A  
in respect of the consideration received by the Governing  
Board for exercising the right of nomination in respect of G  
the defaulter's erstwhile right of membership) and all other  
assets and money of the defaulter in the Exchange or  
the market including the money and securities receivable  
by him from any other member, money and securities of  
the defaulter lying with the Clearing House or the  
Exchange, credit balances lying in the Clearing House, H

- A security deposits, any bank guarantees furnished on behalf of the defaulter, fixed deposit receipts discharged or assigned to or in favour of the Exchange, Base / Additional Capital deposited with the Exchange by the defaulter, any security created or agreed to be created
- B by the defaulter or any other person in favour of the Exchange or the Defaulters' Committee for the obligations of the defaulter to the following purposes and in the following order of priority, viz.:-
- C (i) First - to make any payments required to be made under Bye-law 391 and 394;
- (ii) Second - the payment of such subscriptions, debts, fines, fees, charges and other money as shall have been determined by the Defaulters' Committee to be due to the Securities and Exchange Board of India, to the Exchange or to the Clearing House by the defaulter;
- D (iii) Third - the rectification or replacement of or compensation for any bad deliveries made by or on behalf of the defaulter to any other member in the settlement in which the defaulter has been declared a defaulter or in any prior or subsequent settlement (unless the Governing Board has otherwise determined in respect of such settlement or settlements under Bye-law 394) provided the conditions of Bye-law 153 and all other applicable Rules, Bye-Laws and Regulations and instructions of the Governing Board are complied with;
- E
- F
- G (iv) Fourth - the balance, if any, shall be paid into the Fund to the extent of the money paid out of the Fund (other than payments made out of Members' refundable contributions) and not recovered by the Fund and the interest payable by the defaulter to the Fund in respect thereof;
- H

- (v) Fifth - the balance, if any, shall be paid into the Fund to the extent of the money paid out of the Fund out of the refundable contributions of members (other than the refundable contribution of the defaulter) and not recovered by the Fund and the interest payable by the defaulter to the Fund in respect thereof; A B
- (vi) Sixth - subject to the Rules, Bye-Laws and Regulation of the Exchange, including in particular Bye-Law 343, the balance, if any, shall be applied by the Defaulters' Committee for the payment of such unpaid outstanding, debts, liabilities, obligations and claims to or of members of the Exchange arising out of any contracts made by the defaulter with such members subject to the Rules, Bye-laws and Regulations of the Exchange as shall have been admitted by the Defaulters' Committee; provided that if the amount available be insufficient to pay and satisfy all such debts, liabilities, obligations and claims in full they shall be paid and satisfied pro rata; C D
- (vii) Seventh - subject to the Rules, Bye-Laws and Regulation of the Exchange, including in particular Bye-Law 343, the balance, if any, shall be applied by the Defaulters' Committee for the payment of such unpaid debts, liabilities, obligations and claims to or of the defaulter's constituents arising out of any contracts made by such defaulter subject to the Rules, Bye-laws and Regulations of the Exchange as shall have been admitted by the Governing Board; provided that if the amount available be insufficient to pay and satisfy all such debts, liabilities, obligations and claims in full they shall be paid and satisfied pro rata; E F G
- (viii) Eighth - the balance, if any, shall be paid into the Exchange's Customers' Protection Fund to the H

- A extent of any and all amounts paid out of the Customers' Protection Fund towards the obligations or liabilities of the defaulter and interest thereon at the rate of 2.5% per month (or such other rate as the Governing Board may specify) from the date of payment out of the Customers' Protection Fund to the date of repayment to the Fund; and
- B
- (ix) Ninth - the surplus, if any, shall be paid to the defaulter.
- C Clarification: It is clarified that this Bye-law 400 does not apply to the amount paid by the Governing Board to the Defaulters' Committee pursuant to Rule 16A in respect of the consideration received by the Governing Board for exercising the right of nomination in respect of the defaulter's erstwhile right of membership as the same does not belong to the defaulter and the defaulter has no claim, right, title or interest therein."
- D

9. The judgment under appeal set out two main issues which according to it arose for determination. They are:

- E [A] Whether, on the facts and circumstances of this case, the TRO was right in attaching the sale proceeds of the nomination rights of the Defaulter-Member. If not, whether the TRO was entitled to attach under Rule 26(1) of Schedule -II to the Income Tax Act, the Balance Surplus amount lying with BSE out of the sale proceeds of the nomination rights of the Defaulter-Member under rule 16(1)(iii) framed by BSE r/w the Resolution of the General Body of BSE dated 13.10.1999?
- F
- G [B] Whether deposits made by the Defaulting Member under various Heads such as Security Deposit, Margin Money, Securities deposited by Members and Others are attachable under Section 226(3)(i)(x) read with Rule 26(1)(a)(c) of Schedule-II to the Income Tax Act?

H

10. Issue A was answered by saying that though a defaulting member had no interest in a membership card and that the Income Tax Department was not right in attaching the sale proceeds of such card, still money which is likely to come in the hands of the garnishee, that is the Bombay Stock Exchange, for and on behalf of the assessee is attachable because the requisite condition is the subsistence of an ascertained debt in the hands of the garnishee which is due to the assessee, or the existence of a contractual relationship between the assessee and the Stock Exchange consequent upon which money is likely to come in the hands of the garnishee for and on behalf of the assessee. Issue No.2 was answered by saying that even on vesting of all the assets of the assessee in the defaulter's committee, all such assets continued to belong to the assessee. Section 73(3) Civil Procedure Code mandates that Government debts have a priority and that being so they will have precedence over other dues. It was further held that the lien that the Stock Exchange may possess under Rule 43 does not make it a secured creditor so that debts due to the Income Tax Department would have precedence. The judgment then goes on to say:

"11. To sum up, we hereby declare:

- (a) That, the Other Assets (as described hereinabove) are attachable and recoverable under provisions of section 226(3)(i)(x) read with Rule 26(1)(a)(c) of Schedule-II to the Income Tax Act.
- (b) That, the Government and Other Creditors such as BSE, the Clearing House and Other Creditor Members under Rules and Bye-laws of the Stock Exchange are creditors of equal degree and under Section 73(3), Civil Procedure Code, the Government dues shall have priority over other such creditors.
- (c) That, in the matter of application of Defaulters' Asset under bye-law 400, the Defaulters'

- A Committee shall give priority to the debt due to the Government and the balance, if any, shall be distributed in terms of the Bye-laws 324 alongwith Bye-law 400 of the BSE.
- B (d) That, a sum of Rs. 34,06,680 representing Balance Surplus lying with the Exchange out of sale proceeds of the nomination rights of the Defaulter Member is attachable under the above provisions of the Income Tax Act read with Rule 16 of the BSE Rules and consequently, the said amount is directed to be paid over to the TRO under the impugned Prohibitory Order.
- C
- D (e) We hereby direct the BSE also to hand the securities lying in Members Security Deposit Accounts to the TRO, who would be entitled to sell and appropriate the sale proceeds towards the claim of the Income Tax Department against the Defaulting Broker-Member. If the TRO so direct, those securities could also be sold by BSE and the realized value, on the date of the sale, could be handed over to the TRO. It is for the TRO to decide this point. We further direct credit balance its the Clearing House of Rs. 1,53, 538/- to be paid over to the TRO and that the TRO would be entitled to appropriate the said amount towards the dues of the Department. In short, we are directing BSE to pay a sum of Rs. 35, 60, 218/- to the TRO and in addition thereto, the TRO would be entitled to the realized value of the Securities as on the date of sale. In this case, the Prohibitory Order is before the date of insolvency of the Broker concerned.
- E
- F
- G (f) In future, the principles laid down by this judgment should be followed by BSE and the TRO would to attach such Other Assets and appropriate the amounts towards its claim under the Income Tax Act."
- H

11. Mr. Arvind Datar, learned senior counsel appearing on behalf of the Stock Exchange raised essentially three submissions. The first submission is that by virtue of the judgment in **Stock Exchange, Ahmedabad v. Asstt. Commissioner of Income Tax, Ahmedabad**, 2001 (3) SCC 559, the sale proceeds of a membership card and the membership card itself being only a personal privilege granted to a member cannot be attached by the Income Tax Department at any stage. The moment a member is declared a defaulter all rights qua the membership card of the member cease and even his right of nomination vests in the Stock Exchange. The High Court was therefore not correct in saying that though a membership card is only a personal privilege and ordinarily the Income Tax Department cannot attach the sale proceeds, yet since these amounts came into the hands of the Stock Exchange for and on behalf of the assessee they were attachable. The second argument was made on conjoint reading of Rule 38 and 44. The learned senior counsel argued that all securities in the form of shares that are given by a member shall be transferred and held either in the name of the trustees of the Stock Exchange or in the name of a Bank which is approved by the Governing Board. By operation of Rule 44, on termination of the membership of a broker, whatever remains by way of security after clearing all debts has to be "transferred" either to him or as he shall direct or in the absence of such direction to his legal representatives. The argument therefore is that what is contemplated is a transfer of these shares by virtue of which the member ceases to be owner of these shares for the period that they are "transferred" and this being so, the Income Tax Department cannot lay their hands on these shares or the sale proceeds thereof as the member ceases to have ownership rights of these shares. Shri Datar also argued that by virtue of Rule 43, the Stock Exchange has a first and paramount lien for any sum due to it, and that this made it a secured creditor so that in any case income tax dues would not to be given preference over dues to secured creditors.

- A 12. Shri R.P.Bhat, learned senior counsel arguing on  
behalf of Revenue refuted these contentions and stated that  
on a conjoint reading of the Rules and the Bye-Laws a  
membership card may not be directly attachable but that the  
High Court's reading of Rule 16 is correct. Further, on a conjoint  
B reading of the various Rules relating to member's security, it  
is clear that the expression "transferred" would not refer to  
transfer of ownership but would refer only to the delivery made  
of shares for the purpose of realization in case a member  
defaults. He further argued that the mere fact that a lien was  
C provided in the Rules did not make such lien a statutory lien  
and that therefore Government dues would have a first  
preference over all the dues of the Stock Exchange.

13. Mr. Datar also handed over during the course of  
argument certain annual reports and letters to buttress his  
D argument that in point of fact shares were actually transferred  
by the member under the direction of the Stock Exchange to  
the Bank of India who actually became owner of the shares  
and was treated as such. The fact that dividends were to be  
paid to the member concerned was only because of an internal  
E arrangement between the Exchange and the member, and that  
in fact the right to the dividend as well as the right to vote all  
belonged to the Bank of India who was to act as a trustee for  
the Stock Exchange.

- F 14. We will deal with each one of the contentions seriatim.  
Re.: (1)

- A reading of Rules 5 and 9 lead to the conclusion that a  
membership card is only a personal permission from the Stock  
Exchange to exercise the rights and privileges that may be  
G given subject to Rules, Bye-Laws and Regulations of the  
Exchange. Further, the moment a member is declared a  
defaulter, his right of nomination shall cease and vest in the  
Exchange because even the personal privilege given is at that  
point taken away from the defaulting member. The matter is  
H no longer res integra.

15. In **Isha Valimohamad and Anr. vs. Haji Gulam Mohamad & Haji Dada Trust** 1975 (1) SCR 720 the Supreme Court made a distinction between "privilege" and "accrued right". A

"Mr. Patel for respondent contended that even if the landlord had no accrued right, he at least had a 'privilege' as visualised in Section 51, proviso (1)(ii) of the Bombay Act and that the privilege should survive the repeal. B

A privilegium, in short, is a special act affecting special persons with an anomalous advantage, or with an anomalous burthen. It is derived from *privatum*, which, as opposed to *publican*, signified anything which regards persons considered individually; *publicum* being anything which regards persons considered collectively, and forming a society C

(See Austin's Jurisprudence, Vol. II, 5th ed. (1911) P. 519) D

The meaning of that word in jurisprudence has undergone considerable change after Austin wrote. According to Hohfeld:

... a privilege is the opposite of a duty, and the correlative of a 'no-right'. For instance, where "X has a right or claim that Y should stay off the land (of X), he himself has the 'privilege' of entering on the land; or, in equivalent words, X does not have a duty to stay off. E

Fundamental Legal Conceptions (1923) pp. 38-39 F

Arthur L. Corbin writes:

We say that B had a right that A should not intrude and that A had a duty to stay out. But if B had invited A to enter, we know that those results would not occur. In such case we say that B had no right that A should stay out and that A had the privilege of entering. G

(See "Legal Analysis and Terminology", 29 Yale Law Journal 163)

A According to Kocourek:

Privilege and inability are correlatives. Where there is a privilege there must be inability. The terms are correlatives. The dominus of a Privilege may prevent the servus of the Inability from exacting an act from the dominus

B

(See "Jural Relations", 2nd ed., p. 24)

Patton says:

C

The Restatement of the law of Property defines a privilege as a legal freedom on the part of one person as against another to do a given act or a legal freedom not to do a certain act.

(See Jurisprudence, 3rd ed. (1964), p. 256)

D

We think that the respondent-landlord had the legal freedom as against the appellants to terminate the tenancy or not. The appellants had no right or claim that the respondent should not terminate the tenancy and the respondent had, therefore, the privilege of terminating it on the ground that appellants had sub-let the premises. This privilege would survive the repeal. But the problem would still remain whether the respondent had an accrued right or privilege to recover possession of the premises under Section 13(1) of the Saurashtra Act on the ground of the sub-letting before the repeal of that Act. The fact that the privilege to terminate the tenancy on the ground of sub-letting survived the repeal does not mean that the landlord had an accrued right or privilege to recover possession under Section 13(1) of that Act as that right or privilege could arise only if the tenancy had been validly terminated before the repeal of the Saurashtra Act."

E

F

G

(at Pages 725, 726)

It is clear therefore that no accrued right to property was ever vested in the defaulting member.

H

16. Further, the rules and the bye-laws also make this clear. Under Rule 16(iii), whenever the Governing Board exercises the right of nomination in respect of a membership which vests in the Exchange, the ultimate surplus that may remain after the membership card is sold by the Exchange comes only to the Exchange - it does not go to the member. This is in contrast with bye-law 400 (ix) which, as has been noted above deals with the application of the defaulting member's other assets and securities, and in this case ultimately the surplus is paid only to the defaulting member, making it clear that these amounts really belonged to the defaulting member.

17. In the **Ahmedabad Stock Exchange case**, 2001 (3) SCC 559, this Court has held that:

*"9. The Stock Exchange Rules, Bye-laws and Regulations have been approved by the Government of India under the Securities Contracts (Regulation) Act, 1956. There is no challenge to these Rules. The question whether right of membership confers upon the member any right of property is, therefore, to be examined within the framework of the Rules, Bye-laws and Regulations of the Exchange. On a plain and combined reading of the Rules, it is clear that right of membership is merely a personal privilege granted to a member, it is non-transferable and incapable of alienation by the member or his legal representatives and heirs except to the limited extent as provided in the Rules on fulfilment of conditions provided therein. The nomination wherever provided for is also not automatic. It is hedged by Rules. On right of nomination vesting in the Stock Exchange under the Rules, that right belongs to the Stock Exchange absolutely. The consideration received by the Stock Exchange on exercise of the right of nomination vesting in it, is to be applied in the manner provided in Rule 16.*

- A            13. In the present case Rule 16 was properly  
applied by the Stock Exchange. The membership right  
in question was not the property of the assessee and,  
therefore, it could not be attached under Section 281-B  
of the Income Tax Act. No amount on account of Rajesh  
B            Shah was due from or held by the Stock Exchange and,  
therefore, Section 226(3) could not be invoked. We are  
unable to sustain the judgment under appeal holding  
that in substance the right of membership or  
membership card was a right of property which could  
C            be attached under Section 281-B of the Income Tax  
Act.”

- It is clear therefore that the conclusion of the High Court  
that the proceeds of a card which has been auctioned can be  
paid over to the Income Tax Department for the dues of the  
D            member by virtue of Rule 16 (iii) is incorrect as such member  
at no point owns any property capable of attachment, as has  
been held in the **Ahmedabad Stock Exchange** case. On  
this point therefore Shri Datar is on firm ground and must  
succeed.

- E            Re: (2)

- Rules 36 to 46 belong to a Chapter in the Rules entitled  
“Membership Security”. Rule 36 specifies that a new member  
shall on admission provide security and shall maintain such  
F            security with the Stock Exchange for a determined sum at all  
the times that he carries on business. Rule 37 deals with the  
form of such security and states that it may be in the form of a  
deposit of cash or deposit receipt of a Bank or in the form of  
security approved by the Governing Board. Rule 38 deals with  
G            how these securities are held. Rule 41 enables the member to  
withdraw any security provided by him if he provides another  
security in lieu thereof of sufficient value to the satisfaction of  
the Governing Board. Rule 43 states that the security provided  
shall be a first and paramount lien for any sum due to the Stock  
H            Exchange and Rule 44 deals with the return of such security

under certain circumstances. On a conjoint reading of these Rules what emerges is as follows: A

(i) The entire Chapter deals only with security to be provided by a member as the Chapter heading states;

(ii) The security to be furnished can be in various forms. What is important is that cash is in the form of a deposit and securities are also "deposited" with the Stock Exchange under Rule 37; B

(iii) Rule 38 which is crucial provides how securities are to be "held" which is clear from the marginal note appended to it. What falls for construction is the expression "securities shall be transferred to and held". Blacks Dictionary defines "transfer" as follows: C

*"Transfer means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption."* D

It is clear therefore that the expression "transfer" can depending upon its context mean transfer of ownership or transfer of possession. It is clear that what is transferred is only possession as the member only "deposits" these securities. Further, as has been held in **Vasudev Ramchandra Shelat v. Pranal Jayanand Thakur & Ors.**, 1975 (2) SCR 534 at 541, a share transfer can be accomplished by physically transferring or delivering a share certificate together with a blank transfer form signed by the transferor. The transfer of shares in favour of the Stock Exchange is only E

- A for the purposes of easy liquidity in the event of default.
- (iv) The expression "transferred" must take colour from the expression "lodged" in Rule 38 when it comes to deposits of cash. Understood in this sense,
- B transfer only means delivery for the purposes of holding such shares as securities;
- (v) This is also clear from the language of Rule 38 when it says "such deposit shall be entirely at the risk of the member providing the security ....."
- C Obviously, first and foremost the cash lodged and the shares transferred are only deposits. Secondly, they are entirely at the risk of the member who provides the security making it clear that such member continues to be the owner of the said shares by way of security for otherwise they cannot possibly be at the member's risk;
- D
- (vi) Under Rule 41 a member may withdraw any security provided by him if he satisfies the conditions of the Rules. This again shows that what is sought to be withdrawn is a security which the member owns;
- E
- (vii) By Rule 43 a lien on securities is provided to the Stock Exchange. Such lien is only compatible with the member being owner of the security, for otherwise no question arises of an owner (the Stock Exchange, if Shri Datar is right) having a lien on its own moveable property;
- F
- (viii) Therefore, when Rule 44 speaks of repayment and transfer it has to be understood in the above sense as the security is being given back to the member under the circumstances mentioned in the Rule;
- G
- (ix) Bye-law 326 and 330 also refer to securities that are "deposited" by the defaulter and recovery of securities and "other assets" due. Obviously,
- H therefore, securities which are handed over to the

exchange continue to be assets of the member which can be liquidated on default. A

- (x) Shri Datar's argument would also create a dichotomy between "cash lodged" and Bank Deposit Receipts and securities "transferred". The form a particular security takes cannot possibly lead to a conclusion that cash lodged, being only a deposit, continues to belong to the member, whereas Bank Deposit Receipts and securities, being "transferred" would belong to the Stock Exchange. B C

In **Bombay Stock Exchange v. Jaya Shah**, 2004 (1) SCC 160, this Court was confronted with a claim made by a non-member against a member which had fructified into an arbitration award under the 1940 Arbitration Act which was then made a Rule of the Court and a decree followed. The Bombay High Court made the garnishee notice of the non-member creditor absolute and the Supreme Court was faced with the correct construction of bye-laws relating to defaulter members. The Supreme Court held: D

*"39. How the card money is to be dealt with has been provided under the Rules. A dichotomy, however, has been created under the Rules and Bye-laws as regards the amount received by sale of membership card and amount recovered from the defaulter's other assets. On a plain reading of the Rules and Bye-laws it appears that the authority to deal with the card money and the liability of the members by the Defaulters' Committee is different, but having regard to the scheme of distribution of the liabilities of the Exchange, clearing house, members and non-members, all the assets shall be placed at the hands of the Defaulters' Committee. But as would appear from the discussions made hereinafter the application thereof would be separate and distinct.* E F G

- A            40. In terms of the Bye-laws, a Defaulters' Committee is to be constituted which is a Standing Committee consisting of six members of the Exchange. Such a Committee is constituted in terms of Rule 170(a)(ii) of the Stock Exchange Rules, Bye-laws and Regulations, 1957. It is not a juristic person. It is merely an association of persons.
- B
- C            46. Vesting of such assets of the defaulter in the Defaulters' Committee is not absolute. The Defaulters' Committee is merely a trustee. It holds the said amount vested in it for the benefit and on account of the creditor members. Once the liabilities of the creditors from the defaulters are paid to the members, in terms of Rule 44, the assets devolve upon the Defaulters' Committee in terms of Bye-law 326 for a limited purpose and as
- D            contradistinguished from the Rules in terms whereof the card may vest in the Exchange, do not vest in it absolutely.
- E            47. The Defaulters' Committee takes in its custody the amount realised from other assets not as an owner thereof and the vestment thereof would, thus, be coterminous with the satisfaction of the claims of the member. It, as soon as the purpose of Bye-law 326 is satisfied, comes to an end.
- F            48. The assets of a defaulting member can broadly be divided into two categories, namely, card membership and other assets.
- G            57. There cannot, however, be any doubt that so long as the claims of the awardees, both of members as also non-members, are dealt with by the Defaulters' Committee, the Exchange or the Defaulters' Committee would not be a debtor in relation to an awardee. But once the Defaulters' Committee determines such claims and a surplus is available in the hands of the Defaulters' Committee, as the surplus amount would become
- H

*payable to the defaulting members, the same would become an asset of the defaulting member. In other words, other assets continue to remain assets of the defaulting members subject to the vesting thereof for the purposes mentioned in Bye-law 326 and as soon as the purpose is satisfied, the ownership which was under animated suspension or eclipsed would again revive to the defaulting member. The 'awardees, however, so long as the assets remain under the control of the Defaulters' Committee would be entitled to get their claim on a pro rata basis and not in its entirety.*

58. *If it is held that despite the fact that claims, having regard to the priority clause contained in Rule 16, remain in the hands of the Defaulters' Committee and an order of attachment would be enforceable, the same would result in an incongruity. Unfortunately, no clear picture emerges from the Rules and Bye-laws as there does not appear to be any provision how the card money as also other assets belonging to the defaulting member can be handled by the Defaulters' Committee. But the Rules and Bye-laws have to be read harmoniously. They have to be read together so as to make them effective and workable. So read, the Defaulters' Committee constituted in terms of Bye-laws would apply to the other assets, dues and payments of the members on a pro rata basis whereafter the dues of non-members can be disbursed. While doing so, however, such claims can be determined only having regard to the cut-off date which must be prescribed by the Governing Board in terms of clause (vii) of Bye-law 343. So far as card money is concerned, the same must be disbursed having regard to the priority clause contained in Rule 16, in which event, upon discharge of the dues of the Exchange and clearing house, the same has to be distributed according to the dues of members and non-members. It bears repetition to state*

- A     *that there does not exist any distinction between a member and a non-member in terms of Rule 16 and in the event the amount of the card money available in the hands of the Exchange is not sufficient to satisfy all the claims, the same has to be distributed on a pro rata basis. However, any amount remaining surplus even thereafter would be subject to a decision of the Governing Board. The Governing Board may in a given situation, having regard to the hardship which may be*
- B     *faced by the members and non-members in realising their dues, may direct that such amount would be available for disbursement towards the said dues. It, however, we may hasten to add, is free to apply the surplus for a different purpose which, evidently cannot be de hors the purpose and object for which the Exchange has been constituted."*
- C
- D

18. Ultimately, the matter was remanded to find out what was the cut off date for purposes of limitation.

- E     19. Though this judgment has no direct application to the facts before us it does hold that after the assets of the defaulting member are pooled together and amounts are realized, the payments that would be made from such pool would be from the assets of the defaulting member. To that extent, therefore, the aforesaid judgment reinforces what we have stated above. Mr. Datar's second contention must
- F     therefore fail.

Re: (3)

- G     It is settled law that Government debts have precedence only over unsecured creditors. This was held in **Dena Bank v. Bhikabhai Prabhudas Parekh Co.**, 2000 (5) SCC 694 as follows:

- H     *"10. However, the Crown's preferential right to recovery of debts over other creditors is confined to ordinary or unsecured creditors. The common law of England or the principles of equity and good*

conscience (as applicable to India) do not accord the Crown a preferential right for recovery of its debts over a mortgagee or pledgee of goods or a secured creditor. It is only in cases where the Crown's right and that of the subject meet at one and the same time that the Crown is in general preferred. Where the right of the subject is complete and perfect before that of the King commences, the rule does not apply, for there is no point of time at which the two rights are at conflict, nor can there be a question which of the two ought to prevail in a case where one, that of the subject, has prevailed already. In *Giles v. Grover* [(1832) 131 ER 563 : 9 Bing 128] it has been held that the Crown has no precedence over a pledgee of goods. In *Bank of Bihar v. State of Bihar* [(1972) 3 SCC 196 : AIR 1971 SC 1210] the principle has been recognised by this Court holding that the rights of the pawnee who has parted with money in favour of the pawnor on the security of the goods cannot be extinguished even by lawful seizure of goods by making money available to other creditors of the pawnor without the claim of the pawnee being first fully satisfied. *Rashbehary Ghose* states in *Law of Mortgage* (TLL, 7th Edn., p. 386) — "It seems a government debt in India is not entitled to precedence over a prior secured debt."

What has been argued before us is that the moment the Stock Exchange has a lien over the member's securities, it would have precedence over income tax dues. We find there is force in this submission.

The Provincial Insolvency Act defines "secured creditor" under Section 2 (e) as follows:

(e) "Secured creditor" means a person holding a mortgage, charge or lien on the property of the debtor or any part thereof as a security for a debt due to him from the debtor,"

- A Similarly, the Securitisation and Reconsruction of Financial Assets and Enforcement of Security Interest Act, 2002 in Section 2 (z)(f) defines "security interest" as follows:

B *"Section 2(zf) "security interest" means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in Section 31"*

- C In **Triveni Shankar Saxena v. State of U.P. & Ors.**, 1992 Suppl. 1 SCC 524 at para 17 in an instructive passage the Supreme Court held as follows:

D *"17. We shall now examine what the word 'lien' means. The word 'lien' originally means "binding" from the Latin ligamen. Its lexical meaning is "right to retain". The word 'lien' is now variously described and used under different context such as 'contractual lien', 'equitable lien', 'specific lien', 'general lien', 'partners lien', etc. etc. in Halsbury's Laws of England, Fourth Edition, Volume 28 at page 221, para 502 it is stated :*

E *In its primary or legal sense "lien" means a right at common law in one man to retain that which is rightfully and continuously in his possession belonging to another until the present and accrued claims are satisfied."*

- F Similarly, in **K.S. Saradambal v. Jagannatham K Brothers**, (1972) 42 Companies Case 359, the Madras High Court held:

G *"It would be sufficient only to refer to the following observation in Halsbury's Laws of England, third edition, volume 24, at page 143:*

H *"A legal lien differs from a mortgage and a pledge in being an unassignable personal right which subsists only so long as possession of the goods subsists. A mortgage is an assignable right in the property charged*

and does not depend on possession. A pawn or pledge gives a special assignable interest in the property to the pawnee. A lien is, however, included in the definition of mortgage in the Law of Property Act, 1925. There an equitable mortgage is created by deposit of title deeds, the mortgagee has a legal lien on the deeds deposited."

This leads us to the question as to what right is available to the applicant-company, as the holder of lien. That again takes us to the question as to what is meant by "lien". The word "lien" is defined in the Law Lexicon by Ramanatha Iyer as:

"A lien may be defined to be a charge on property for the payment of a debt or duty, and for which it may be sold in discharge of the lien.....A lien, in a limited and technical sense, signifies the right by which a person in possession of personal property holds and retains it against the owner in satisfaction of a demand due to the party retaining it; but in its more extensive meaning and common acceptance it is understood and used to denote a legal claim or charge on property, either real or personal, as security for the payment of some debt or obligation; it is not strictly a right in or right to the thing itself but more properly constitutes a charge or security thereon." The word "lien" is defined in Stroud's Judicial Dictionary, third edition, at page 1644, as:

"A lien- (without effecting a transference of the property in a thing) – is the right to retain possession of a thing until a claim be satisfied; and it is either particular or general".

Having regard to the foregoing definitions the question arises whether the holder of a lien, as the applicant company in the instant case, can be considered to be a secured creditor under the company law. Section 529 of the Act is important and it reads:

- A        *"529. Application of the insolvency rules in winding up of insolvent companies.- (1) In the winding up of an insolvent company, the same rules shall prevail and be observed with regard to –*
- B        (a) *Debts Probable;*
- (b) *The valuation of annuities and future and contingent liabilities; and*
- (c) *The respective rights of secured and unsecured creditors;*
- C        *As are in force from the time being under the law of insolvency with respect to the estates of persons adjudged insolvent.*
- (2) *All persons who in any such case would be entitled to prove for and receive dividends out of the assets of the company, may come in under the winding up, and make such claims against the company as they respectively are entitled to make by virtue of this section.*
- D        *Provided that if a secured creditor instead of relinquishing his security and proving for his debt proceeds to realize his security, he shall be liable to pay the expenses incurred by the liquidator (including provisional liquidator, if any), for the preservation of the security before its realization by the secured creditor".*
- E        *Though the expression "insolvent company" is not defined, obviously it refers to a company which has been ordered to be wound up on a petition founded upon section 433 (c), that is, the company being unable to pay its debts. According to section 529, in the winding up of such a company, the same rules shall prevail and be observed with regard to debts provable as are in force for the time being under the law of insolvency with respect to the estates of the persons adjudged insolvent.*
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*The question is whether only the insolvency rules are applicable or all the relevant provisions of the insolvency law are applicable to a case of winding up of an insolvent company.* A

*The intention underlying section 529 is that all the provisions of the insolvency law are applicable to the case of winding up of an insolvent company with regard to matters enumerated in section 529. That was also the view taken by a full bench of the Allahabad High Court in Hans Raj v. Official liquidators, Dehradun, Mussorie Electric Tramway Co. Ltd. AIR 1929 All 353 (F.B.). A similar view was taken by the Oudh Chief Court in B. Anand Bihari Lal v. Dinshaw & Co. (1944) 12 Comp. Cas. 137 (Oudh). Thus, according to section 529, the provisions of the insolvency law are applicable to debts provable in the winding up of an insolvent company. That takes us to the question as to what are the provisions of the insolvency law that are applicable to a debt covered by a lien. The provincial Insolvency Act, 1920, and the Presidency Towns Insolvency Act, 1909, define "secured creditor". In the former Act, section 2(e) defines that expression as:* B  
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*"2.(e) 'Secured creditor' means a person holding a mortgage, charge or lien on the property of the debtor or any part thereof as a security for a debt to him from the debtor."* F

*In the latter Act, Section 2(g) defines that expression as:*

*"Secured creditor' includes a landlord who under any enactment for the time being in force has a charge on land for the rent of that land."* G

*The latter definition is an inclusive definition. According to the former definition even a person holding a lien on the property of a debtor is a secured creditor. In dealing with the question as to who a secured creditor* H

A *is in company law, it is observed in Palmer's Company Law, 21st edition, at page 765.:*

B *"Secured creditor is one, who has some mortgage, charge or lien on the company's property.....A solicitor who holds a lien on documents of a liquidating company for his costs against the company is a secured creditor, and must mention his lien in his proof."*

C *On a consideration of Section 529 read with the relevant provisions of the insolvency law, I come to the conclusion that the holder of a statutory lien or the holder of a lien created by contract and registered as required by Section 125 is a secured creditor in the matter of winding up of the insolvent company with regard to, among other things, debts provable in the winding up proceedings. The applicant-company being the holder of a statutory lien is thus in the position of a secured creditor....."*

D 20. In the present case, the first and paramount lien given to the Stock Exchange is by Rule 43 of the Rules made under Section 8 of the Securities Contract Act. Sections 7A, 8 and 30 of the Securities Contracts (Regulation) Act 1956 deal with the power of recognized Stock Exchanges making rules restricting voting rights; rules relating to Stock Exchanges generally including membership thereof; and rules to carry out the purposes of the Securities Contracts (Regulation) Act respectively. Whereas, the rules made under Section 7A and Section 8 are made by recognized Stock Exchanges with the approval of the Central Government and published in the Official Gazette, rules made under Section 30 are made by the Central Government itself for purposes of carrying into effect the objects of the Securities Contracts (Regulation) Act. Sub-section (3) of Section 30 is material.

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H *"Section 30 sub-section (3): Every rule made under this Act shall be laid, as soon as maybe after it is made, before each House of Parliament, while it is in session*

for a total period of thirty days which may be comprised A  
in one session or in two or more successive sessions,  
and if, before the expiry of the sessions immediately  
following the sessions or the successive sessions  
aforesaid, both Houses agree in making any modification  
in the rule or both Houses agree that the rule should not B  
be made, the rule shall thereafter have effect only in such  
modified form or be of no effect, as the case may be; so,  
however, that any modification or annulment shall be  
without prejudice to the validity of anything previously  
done under the rule. " C

21. It will be seen that whether a rule is made under  
section 7-A, Section 8 or Section 30, all rules made under the  
Act are to be laid before Parliament, making it clear thereby  
that rules made under each of these provisions are statutory D  
in nature. The fact that the Stock Exchange makes these rules  
under Sections 7A and 8 as opposed to the Central  
Government making them under Section 30 does not take the  
matter very much further. Section 3(51) of the General Clauses  
Act defines "Rules" as meaning "a rule made in exercise of E  
power conferred by law and shall include a Regulation made  
as a rule under any enactment." It is clear from this definition  
of 'Rule' also that Stock Exchanges who make rules in exercise  
of powers conferred by the Securities Contracts (Regulation)  
Act are equally "Rules" and therefore subordinate legislation.  
This makes it amply clear that the lien spoken of by Rule 43 is F  
a lien, conferred by Rules under a statute.

22. Mr. Bhat argued that only a lien that flows from the  
statute itself can be considered as a statutory lien and referred  
us to two judgments, one by the Bombay High Court and one G  
by the Supreme Court.

The Bombay High Court held in the case of **Forwarding  
P. Ltd. and another v. Trustees, Port of Vizagapatnam,  
and Anr.**, (1987). 61 Company Cases 513 that the power of  
arrest and sale of vessel belonging to a company in winding H

A up by the port authorities emanates directly from section 64 of the Major Port Trusts Act, 1963 and hence the question of obtaining leave of the company court under section 446 of the Companies Act, 1856 will not arise when an authority exercises independent statutory rights.

B This judgment was quoted with approval in **Board of Trustees, Bombay vs. Indian Oil Corporation**, 1998 (4) SCC 302 where the Supreme Court set out Section 64 of the Major Port Trusts Act and held as under:

C *"8. The Port authorities have a paramount right to arrest a vessel and detain the same until the amounts due to it in respect of extending the port facilities and services to the vessel are paid. Under Sub-section (2), in case any part of the said rates, charges, penalties or the cost of the distress or arrest or of the keeping of the same remain unpaid for a space of five days next after any such distress or arrest has been made, the Board may cause the vessel so distrained or arrested to be sold. The proceeds of such sale shall satisfy such rates or penalties and costs including the costs of sale remaining unpaid. The surplus, if any, is to be rendered to the master of such vessel on demand.*

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*9. The statutory right under Section 64 embodies this overriding right of the harbour authority over the vessel for the recovery of its dues. This right stands above the rights of secured and unsecured creditors of a company in winding up - in the present case, the shipping company which owns the vessel. The harbour authorities allow ships - national or foreign to anchor and avail of the services provided by them. For payment they look to the vessel. The owner may be foreign or even unknown to the harbour authority. The latter's right to recover its dues is not affected by any pending proceedings against the owner in any court - whether in winding up or otherwise. The harbour authority can arrest*

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*the vessel while it is anchored in the harbour and recover its dues in respect of that vessel by sale of the vessel if the dues are not paid. This lien of the harbour authority over the vessel is paramount. The lien cannot be extinguished or the vessel sold by any other authority under the directions of the court or otherwise, unless the harbour authority consents to such sale. Thus, in the case of Ashok Arya v. M.V. Kapitan Mitsos, the Bombay High Court relied upon the decision in The Emilie Millon (infra) and held that the lien given by statute to a dock or harbour authority cannot be extinguished by court unless it be done with the authority's express or implied consent.*

13. *Therefore, the lien of a harbour authority over the vessel is a paramount lien and realization of its dues by the harbour authority by the sale of the vessel is above the priorities of secured creditors. In other words, the statutory lien of a harbour authority has paramountcy even over the claims of secured creditors in a winding up. In exercise of its right under Section 64 the appellant is, therefore, entitled to sell the vessel without the intervention of the court. In exercise of that paramount right which overrides the claims of all other creditors including secured creditors, the appellant has a right to arrest the vessel and sell it. Without the consent of the appellant, this right cannot be transferred to the sale proceeds of the vessel."*

It is no doubt true that the Supreme Court held that the statutory lien of a Harbour authority over a vessel is a paramount lien which overrides the claim of all other creditors including secured creditors. The question, however, in the present case is somewhat different. The question is whether the lien exercised under Rule 43 by the Stock Exchange can be said to be a superior right to income tax dues which may become payable by virtue of the Stock Exchange being a secured creditor.

- A        23. It was argued that Black's Law Dictionary 5th Edition defines "statutory lien" as follows:

"Statutory lien: A lien arising solely by force of statute upon specified circumstances or conditions, but does not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is made fully effective by Statute."

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- C        Based on this it was further argued that such lien would not include any lien provided by or dependent on an agreement to give security, whether or not such lien is also provided by or dependent upon statute, and whether or not such lien is made fully effective by statute.

- D        24. The first thing to be noticed is that the Income Tax Act does not provide for any paramountcy of dues by way of income tax. This is why the Court in Dena Bank's case (supra) held that Government dues only have priority over unsecured debts and in so holding the Court referred to a judgment in Giles vs. Grover (1832) (131) English Reports 563 in which it has been held that the Crown has no precedence over a pledgee of goods. In the present case, the common law of England qua Crown debts became applicable by virtue of Article 372 of the Constitution which states that all laws in force in the territory of India immediately before the commencement of the Constitution shall continue in force until altered or repealed by a competent legislature or other competent authority. In fact, in **Collector of Aurangabad and Anr. vs. Central Bank of India and Anr.** 1967 (3) SCR 855 after referring to various authorities held that the claim of the Government to priority for arrears of income tax dues stems from the English common law doctrine of priority of Crown debts and has been given judicial recognition in British India prior to 1950 and was therefore "law in force" in the territory of India before the Constitution and was continued by Article 372 of the Constitution (at page 861, 862).
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25. In the present case, as has been noted above, the A  
lien possessed by the Stock Exchange makes it a secured  
creditor. That being the case, it is clear that whether the lien  
under Rule 43 is a statutory lien or is a lien arising out of  
agreement does not make much of a difference as the Stock  
Exchange, being a secured creditor, would have priority over B  
Government dues.

26. The three issues are answered as above. The Stock  
Exchange's appeal is allowed and the impugned judgment  
passed by the Division Bench of the Bombay High Court is C  
set aside.

Rajendra Prasad

Appeal allowed.