

Case No. 40
III (2003) BC 549 (DB)
Himachal Pradesh High Court

Kamlesh Sharma & Kuldip Chand Sood, J.J
PUNJAB NATIONAL BANK - Petitioner
Vs
NARAIN DASS & ORS - Respondents
R.F.A. No. 64 of 1997 - Decided on 31-10-2002

**Hypothecation agreement - loan repayable in instalments - default committed by
the borrower - bank is entitled to charge increased interest.**

Result : Appeal Partly allowed

Cases Referred

1. (1994) 5 SCC 213 = 1994 AIR S.C.W. 2721 (Para 21)
2. VII (2001) SLT 400 = (2002) SCC 367 = AIR 2001 SC 3095 (Para 25)

COUNSEL FOR THE PARTIES

For the Appellant : Ms. Devyani Sharma, Advocate

For the Respondents : Mr. Sanjeev Bhushan vice Mr. Ajay Sharma, Advocates.

JUDGEMENT

Kuldip Chand Sood, J.—This first appeal arises out *of* the judgment and decree of learned District Judge, Hamirpur dated January 10, 1997 whereby the suit of the appellant Bank, plaintiff before the District Judge, was partly decreed against the respondent-defendant.

2. The facts in brief.

3. Plaintiff Bank is a Body Corporate established under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 with its head office at New Delhi. Plaintiff Bank has a Branch at Jahu in Tehsil Bhoranj of District Hamirpur of Himachal Pradesh. Vinod Kumar Chadha was the Branch Manager of the Jahu Branch of the plaintiff Bank when the suit was filed. He holds general power of attorney on behalf of the plaintiff Bank and was authorised to maintain the present suit.

4. On August 18, 1987, Bhagat Ram, defendant, who died during the pendency of the suit and was substituted by his legal representatives as defendants 1 (a) to 1 (c) and respondent Nos. 1 to 3 in this appeal, approached the plaintiff Bank for the grant of term loan of Rs. 1,64,000/- for the purchase of D.C.M. Toyota Make Truck *vide* his loan application of the even date. The plaintiff Bank sanctioned a sum of Rs. 1,44,000/- in favour of Bhagat Ram. The sanction was subject to Bhagat Ram executing the necessary loan documents. Defendant Nos. 2 and 3 Brikam Dass and Chander Ram, respectively, were the guarantors for the due repayment of the loan amount together with interest. Bhagat Ram did not repay the loan amount in accordance with the agreed schedule. Plaintiff filed a suit in this Court for the recovery of Rs. 2,31,618/- alongwith *pendente lite* and future interest at the rate of 17% per annum with quarterly rests from the date of the suit till the date of realization of the amount.

5. It transpires during the pendency of the suit, the truck HID 8753 which was hypothecated with the Bank was sold in auction for Rs. 55,000/- and this amount was released to the plaintiff Bank in terms of the orders of this Court dated April 7, 1994.

6. The case of the plaintiff Bank was Bhagat Ram agreed to pay the amount with interest of 2.5% over and above the Reserve Bank of India rate with a minimum of 12.5% per annum with quarterly rests. The loan was stipulated to be paid in 48 equal monthly instalments of Rs. 3,000/- along with interest commencing from one month after the date of the loan, i.e., December 13, 1987, It was agreed by Bhagat Ram and guarantors that the interest was liable to be charged at the rate as may be applicable from time-to-time. The loanee and guarantors also agreed to pay the penal interest in case of default in the payment of instalments at the rate of 2% over and above the agreed rate as applicable from time-to-time.

7. Plaintiff relied upon various confirmation letters including balance confirmation of March 15, 1988, March 15, 1989 and October 24, 1990. It is the further case of the plaintiff Bank that as the default was made by Bhagat Ram and guarantor in the payment of instalments, therefore, the plaintiff Bank was entitled to penal interest as agreed between the parties. Bhagat Ram failed to repay the loan and interest despite demands made including demands made by legal notices on various dates. Copies of those notices were also sent to the guarantors defendant nos. 2 and 3. It was the case of the plaintiff Bank that an amount of Rs 2,08,669/- inclusive of interest upto 2.4.1999 was due from the defendant. For this purposes the plaintiff bank rely upon the statement of accounts, certified in accordance with the Bankers Books Evidence Act. Plain-

tiff bank also claimed Rs.22, 949/- on account of interest and other charges with effect from April 23,1991 till the date of filing of the suit, that is December 30,1991. Plaintiff bank claimed in all Rs. 2,31,618/- from the defendants. Plaintiff bank also claimed future interest at the rate of 17.5% per annum with effect from December 31,1991, that is, the date succeeding the date of filing of the suit of the payment along with interest in its entirety.

8. The defendants filed joint written statement. The suit was resisted. The allegations were controverted. The factum of the loan of Rs.1, 44,000/- having been taken by defendant Bhagat Ram from the Bank is not denied. The case of the defendants was that some blank printed documents were got signed from the defendants. However, it was agreed that simple interest at the rate of 12% per annum would be charged from Bhagat Ram. It is specifically denied that the defendants ever agreed to pay penal interest or other charges as claimed by the Plaintiff Bank. It was denied that defendants had agreed to pay interest of 2.5% above the Reserve Bank of India rate with minimum of 12.5% with quarterly rests. It is also denied that defendants agreed to pay interest as may be applicable from time-to time. The definite case of the defendants was that the agreed rate of interest was simple 12% per annum and defendants never agreed to pay any penal interests or other charges on the loan amount. In the and, it was prayed that if any amount was found to be due from the defendants, then it may be directed to be repaid in easy instalments.

9. Following issues were settled for determination:

1. Whether the suit has been filled on behalf of the plaintiff by a duly authorised person?
2. Whether the suit is within limitation?
3. Whether the plaintiff is estopped from filling the suit, as alleged in para 4 of the preliminary objection?
4. Whether the suit is premature, as alleged?
5. To what amount is the plaintiff entitled to recover from the defendants?
6. Whether the plaintiff is entitled to interest. If so, at what rate and from which date?
7. Relief.

10. It appears by notification dated February 21,1995, the suit was transferred to the files of District Judge, Hamirpur for disposal in accordance with law.

11. The learned District Judge by its impugned judgment found that the plaintiff Bank

was entitled to an amount of Rs. 88,500/- as principal amount on the date of decision and decreed the suit accordingly with simple interest at the rate of 12.5% per annum from the date of decision of the suit till realization of the decretal amount. Learned District Judge also allowed simple interest of 12.5% per annum on principal amount of Rs.1,44,000/- from the date of institution of the suit till April 7, 1994 along with simple interest of Rs.48,750/- at the rate of 12.5% from the loan till the date of institution of the suit after adjusting Rs.13,500/-. The District Judge also permitted simple interest from April 8, 1994 till the decision of the suit. Proportionate cost of the suit was also allowed to the plaintiff bank. The defendants were held to be liable jointly and severally. Learned District Judge held that the suit was filed by a competent person on behalf of the plaintiff bank and was within the period of limitation. The plea of estoppel raised by the defendants under Issue No.3 was also held against the defendants. The case of the defendants that suit was premature under Issue No.4 was rejected.

12. Dissatisfied with the judgment and decree of the Trial Court, the plaintiff Bank is in this appeal.

13. The grievance of the plaintiff Bank, in appeal is that the suit of the Bank ought to have been decreed in its entirety. It was not permissible to the Trial Court to have reopened the question of interest. The court was bound to allow the interest in accordance with the agreement and loan documents.

14. We have heard Ms. Devyani Sharma, learned counsel for the appellant and Mr. Sanjeev Bhushan, learned counsel appearing for the respondents. We were also taken through the record by the learned counsel for the parties.

15. Brikam Dass, son of Shri Bhagat Ram appearing as DW1 stated that the loan taken by his father was for agricultural purposes for which purpose a passbook was given and therefore, only simple interest was chargeable on the loan amount at 12.5% per annum. The loan being agricultural, penal interest was not payable nor any other charges could be levied. It was his evidence that out of the total loan amount of Rs.1,44,000/-, Rs.85,200/-were deposited with the plaintiff bank. He denied that his father had signed the loan documents Exhibits P-3, P-4, P-6, P-7, P-8, P-9, P-10 and P-14. However, he admitted his signatures on guarantee deed Exhibit P-5. He admitted that DCM Toyota truck was purchased by his father from the loan amount obtained from the bank. He was unable to state when precisely his father deposited the amount claimed by him in the bank. As per statement of account (Ext.P-2) Rs.29, 500/- were paid by Bhagat Ram towards loan amount prior to the institution of the suit. During the pen-

dency of the suit, an amount of Rs.55,000/- was also paid to the plaintiff bank towards the suit amount after the auction of the truck of the defendants in terms of the order off this court dated April 7,1995. A contention was raised on behalf of the defendants that the entire amount of Rs.85,000/- i.e. Rs.29,500/- paid before the institution of the suit and Rs.55,000/- realized as sale proceeds of the truck during the pendency of the suit, was liable to be adjusted towards interest. Learned Trial Court directed that so far payment of Rs.29, 500/- by deceased Bhagat Ram to the a bank prior to the institution of the suit was concerned, it was liable to be adjusted towards the interest to be computed on the loan amount of Rs.1,44,000/- from the date of advancement till July 12,1997 but took a view that the sale proceeds of Rs. 55,000/- of the truck and deposited with the bank were liable to be adjusted towards the principal amount. Learned Trial Court after adjusting Rs. 55,000/- took a view that unpaid principal amount comes to Rs. 1,44,000/- minus 55,000/- = 88,500/-.

16. On the question of interest, learned trial judge held that loan of Rs.1,44,000/- was advanced by the plaintiff bank to the loanee as "agricultural loan" and in accordance with the regulations and directions of the Reserve Bank of India, compound interest could not be charged on the agricultural loan. Learned trial judge heavily relied upon the balance confirmation letters Exhibits P-9, P-10 and P-14 in which the loan was described to be agricultural loan and the vehicle financed as "agricultural truck". Learned trial judge also noticed the two notices sent to the loanee exhibits P-15 and P-16 where also the vehicle loan was described as "agriculture truck". These documents were not disputed before the learned Trial Court by the plaintiff and it is in this context and the trial judge held that the loan advanced to the loanee was agricultural loan and could not be subjected to compound interest.

17. Ms. Devyani Sharma, learned Counsel for the appellant strenuously urged that the loan advanced to the loanee Bhagat Ram was a commercial transaction and not agricultural and it was specifically stipulated in the loan documents that interest would be charged at quarterly rests.

18. It is to be noticed that even Vinod Kumar Chadhaa, the power of attorney of the plaintiff bank and concerned branch manager appearing as PW1 admitted that the pass book Ext.D-1 was given by their bank to the loanee and according to this pass book the purpose of the loan was agriculture loan. In his own words: " pass Book Exhibit D-1 was given by our bank. According to this, purpose of the loan written is agricultural truck".

19. Perusal of Exhibit D-1 shows that this was a passbook given to the loanee Bhagat

Ram under "priority Sector loan". The loan account is termed as agriculture (Tpt) Truck No.HID 8753. In the column "purpose of loan" it is described as "Agr.(Tpt) Truck HID 8753". The rate of interest is mentioned as 12.5% per annum. The column where interest is payable half-yearly or annually is left blank. The loan was made returnable in 48 months. Balance confirmation letters Exhibits P-9, P-10 and P-14, on which the plaintiff bank heavily rely, show that loan was agricultural loan. Exhibit P-9 is the balance confirmation letter dated March 15,1989. The columns in it were admittedly filled by the plaintiff bank itself. It is recorded in this confirmation letter that Bhagat ram confirms the correctness of balance of Rs.1, 49,170.35 paise on account of loan No.T/C TPT (Agr)-1727. To similar effect is the balance confirmation letter dated March 15,1988 and Exhibit P-14 dated October 20,1990. This un rebutted evidence clearly establishes that the loan extended to the deceased Bhagat Ram was "agricultural loan" and not "commercial loan" as maintained by the bank.

20. There cannot be any dispute that on the agricultural loan, the plaintiff bank was entitled to simple interest at the rate of 12.5% per annum and not compound interest.

21. It is no longer *res. integra* that the rate of interest, on Agricultural loan notwithstanding the provisions of Section 21-A of the Banking Regulation Act, 1949, has to be simple agreed rate of interest and not rate of interest compounded on monthly, quarterly or six monthly rests. The Supreme Court in *Corporation Bank v. D.S. Gowda*, (1994) 5 SCC 213=1994 AIR S.C.W.2721, interpreting the provisions of Section 21-A of the Act and the various circulars and instructions issued by the Reserve Bank of India took a view that in case of agricultural loan/advances, the circulars of Reserve Bank of India do not permit Banks to charge compound interest with quarterly rests and such loans cannot be treated at par with the commercial loans insofar as rate of interest was concerned. In para 23 of the judgment, Their Lordships observed:

"23. Insofar as Civil Appeal No. 544 of 1986 is concerned it relates to the Bank's right to charge compound interest i.e., interest with periodical rests on agricultural advances. We have already referred to the various circulars issued by the Reserve Bank from time-to-time in exercise of power conferred by Section 21/35-A of the Banking Regulation Act. We have pointed out that the said circulars/directives provide that agricultural advances should not be treated on a par with commercial loans insofar as the rate of interest thereon is concerned because the farmers do not have any regular source of income except sale proceeds of their crops which income they get once a year. The question of recovery of interest with quarterly or six-monthly rests from farmers is, therefore, not feasible. The fact that the farmers are fluid at a given point

of time every year has to be kept in mind in determining the point of time when they should be expected to repay the loan or pay the installment/interest in advances. Therefore, to allow the Banks to charge interest on quarterly or half yearly rests from farmers would tantamount to virtually compelling them to pay compound interest, since they would not be able to pay the interest once in a year i.e., when they receive the income from sale proceeds of their crops. The Reserve Bank has shown concern for the farmers by directing all Banking institutions to so regulate the recovery of interest as to coincide with the point of time when the farmers are fluid. It has, therefore, been emphasised by the Reserve Bank that interest should be charged once a year to coincide with the point of time when the farmer is fluid and interest on current dues should not be compounded although it may be done when the advance/installment becomes overdue. *Thus according to the circulars/directives, so far as loans for agricultural purposes are concerned, at best interest may be charged with yearly rests and may be compounded if the loan/ installment becomes overdue. In the present case, since interest was charged with six monthly rests that was clearly in contravention of the Reserve Bank Circulars/ directives. Compounding of interest on current dues on agricultural advances having been discouraged, the Bank was not entitled to charge interest with shorter periodical rests and compound the same. The bank could add interest outstanding to the principal and compound the interest when the crop loan or term loan becomes overdue having regard to the tenor of the circular dated 14.3.1972. The High Court was, therefore, fully justified in coming to the conclusion that the bank was not entitled to charge interest with half-yearly rest."*

22. In para 25, it was again observed that so far agricultural loan/advances were concerned, it was not permissible to the banks to charge compound interest with quarterly rests. At best, interest could be fixed with annual rest coinciding with the time that the farmer is fluid and if thereafter the farmer fails to pay the interest, it would be open to compound the interest on the crop loan or instalments upon the term loan becoming due. Para 25 of the judgment reads:

"25. We are in respectful agreement with the above interpretation placed on Section 21-A of the Banking Regulation Act. We must, however, clarify that we should not be understood to be expressing any opinion whatsoever on the question whether Section 21-A would debar the

courts from interfering if the circulars/ directives issued by the Reserve Bank do not fix the maxima and leave it to the discretion of the Banks to determine the rate of interest above the minimum fixed. To put it differently if under the Reserve Bank circulars/ directives the minimum rate of interest is fixed, say 12.5% without a ceiling, leaving it to the discretion of each bank to fix a higher rate of interest fixed by the bank is excessive and unconscionable and whether in such situation Section 21-A would debar the court from reducing the rate of interest to a reasonable limit. We do not express any opinion on this question, as the same does not arise in the present case. But if the Reserve Bank fixed the maximum rate of interest in exercise of the powers conferred by Section 21/35-AA of the Banking Regulation Act, Section 21-A would be attracted and the transaction would not be liable to be reopened on the ground that the rate of interest fixed is excessive even though not exceeding the ceiling determined by the Reserve Bank. In the case of agricultural loans/ advances the position has been made amply clear by the circulars referred to earlier, which do not permit banks to charge compound interest with quarterly rests. In such cases as observed earlier the interest can be fixed with annual rests coinciding with the time when the farmer is fluid and if thereafter the farmer fails to pay the interest it would be open to compound the interest on the crop loan or instalments upon the term loans becoming overdue. In view of the above, we do not see any flaw in the reasoning of the High Court so far as this appeal is concerned. We, therefore, must dismiss the appeal."

23. Taking into consideration the evidence on record discussed above, we are of the view that the loan advanced to the loanee was agricultural loan and not a commercial loan and, therefore, it was not open to the plaintiff bank to charge interest with quarterly rests. The plaintiff bank, however, would be entitled to compound the interest with annual rests if the loanee failed to pay the interest.

24. So far the question of payment of guarantee fee or guarantee charges by the loanee is concerned, the plaintiff bank has not claimed such charges in the plaint. It is not the case of the plaintiff bank that guarantee fees or guaran-

tee charges are payable by the loanee pursuant to the direction or circulars of the Reserve bank of India traceable to section 21(2)(e) of the Act. Even if such claim was made, it was for the bank to prove specifically that the payment of such charges was the term of the agreement under which the loan was sanctioned. In our view, the plaintiff bank was not entitled to guarantee fee or guarantee charges as claimed by the bank in the statement of account Exhibit P-2. Similarly, the plaintiff Bank will also not be entitled to inspection fees, charges for the legal notice or recall notice and charges on account of Photostat.

25. So far the question of penal interest is concerned, we find that clause 6 of the agreement of hypothecation Exhibit P4 stipulates, if any of the instalments is defaulted by the loanee or the interest is not paid on the due dates or if the entire amount is recalled by the bank on default, then the loanee would pay increased interest at the rate of 3% per annum over and above the agreed rate of interest. Admittedly, the loanee made a default in the payment of the instalments of the loan amount and, therefore, the bank was entitled to charge penal interest. However, a constitution bench of the Supreme Court in *Central Bank of India v. Ravindra*, VII (2001) SLT400=(2002) 1 SCC 367=AIR 2001 SC 3095, held that penal interest is an extraordinary liability incurred by a debtor for not making the payment when it ought to have been made to the person who advanced the loan. Therefore, it was not limited to the damages suffered. While liability to pay interest is founded on the doctrine of compensation, penal interest is a penalty founded on the doctrine of penal action. Penal interest can be charged only once for one period and, therefore, cannot be permitted to be capitalized. In para 38 of the judgment Their Lordships Held:

“However, “penal interest” has to be distinguished from “interest”. Penal interest is an extraordinary liability incurred by a debtor on account of his being a wrong-doer by having committed the wrong of not making the payment when it should have been made, in favour of the person wronged and it is neither related with nor limited to the damages suffered. Thus, while liability to pay interest is founded on the doctrine of compensation, penal interest is a penalty founded on the doctrine of penalaction. *Penal interest can be charged only once for one period of default and, therefore, cannot be permitted to be capitalised*”

(Emphasis given)

26. In para 55 (1), finding was crystallized thus :

“Through interest can be capitalised on the analogy that the interest falling due on the accrued date and remaining unpaid, partakes the charactor of amount

advanced on that date, yet penal interest, which is charged by way of penalty for non-payment, cannot be capitalised. Further interest *i.e.*, interest on interest, whether simple, compound or penal, cannot be claimed on the amount of penal interest. *Penal interest cannot be capitalised. It will be opposed to public policy*".

(Emphasis given)

27. No other point was urged before us.

28. In the facts and circumstances and for the reasons discussed above. We hold:

(a) The loan advanced to the loanee Bhagat Ram was agricultural loan and, therefore, the plaintiff Bank was not entitled to charge interest with quarterly rests. When default of instalment was made in terms of the loan agreement, then interest could only be capitalised annually;

(b) Defendants are liable to pay simple interest at the rate of 12.5% per annum on the loan amount subject to the adjustment of payments made from time-to-time including the amount of Rs. 55,000/- paid on the sale of the hypothecated truck of the loanee during the pendency of the suit;

(c) The plaintiff Bank is not entitled to guarantee fee, inspection fee, or charge on account of legal or recall notice.

(d) The plaintiff Bank is not entitled to capitalisation of penal interest.

29. The appeal is partly allowed in the above terms. The Registry shall prepare the decree sheet accordingly. There will be no order as to costs.

Appeal partly allowed