CENTRAL BANK OF INDIA

v.

RAVINDRA AND ORS.

OCTOBER 18, 2001

[DR. A.S. ANAND, C.J., K.T. THOMAS, R.C. LAHOTI, N. SANTOSH HEGDE AND S.N. VARIAVA, JJ.]

Code of Civil Procedure, 1908 : Section 34 [as amended by the Code of Civil Procedure (Amendment) Act (66 of 1956) w.e.f. 1.1.1957]

Recovery of money—Suits for—By Banking Institutions against their borrowers—"Principal sum adjudged" and "such principal sum"—Bank sanctioned loan to borrower—Loan carried 11% interest per annum—Bank instituted suit for recovery of money—Trial court decreed suit for the total outstanding amount inclusive of interest on the date of institution of suit with 8% future interest per annum—On appeal, High Court directed interest at 11% per annum to be payable only on the principal sum from the date of suit till realisation though the decree for the original amount was maintained—Correctness of—Held : Subject to contract between parties interest on loans and advances may be charged on periodical rests and also capitalised on remaining unpaid—Principal sum actually advanced coupled with the interest on periodical rests so capitalised is the principal sum on the date of suit—The principal sum so adjudged is "such principal sum" on which interest pendente lite and future interest i.e. post decree interest may be awarded by court—However, penal interest cannot be capitalised.

Recovery of money—Suits for—By Banking institutions against their borrowers—Pleadings—Held: There must be an averment in the plaint that interests and capitalisation thereof are in accordance with the directions of RBI—A statement of account to this effect to be filed—Onus is on the borrower to show why the principal sum as claimed cannot be accepted and adjusted—This practice would narrow down the scope of controversy and enable expeditious disposal of suits—Banking Regulations Act, 1949.

Banking Regulations Act, 1949 :

Sections 21 and 35-A—Banking practice—Role of RBI—Directives/circulars—Held: RBI should continue to issue directives/circulars dealing with

rate of interest, periodical rests and capitalisation of interest—Such directives/ circulars are binding on the concerned parties—Such directives may be treated as standards for deciding whether interest charged is excessive, usurious or opposed to public policy.

Interpretation of Statutes :

Rules of construction—Principles—Held: a construction, which leads to repugnancy or inconsistency, has to be avoided—Ordinarily, a word or expression used at several places in an enactment should be assigned the same meaning.

Words and Phrases :

"The Principal sum adjudged" and "such principal sum"—Meaning of—In the context of S.34(1) of the Code of Civil Procedure, 1908.

The petitioner-bank sanctioned a loan to respondent No. 1 on the guarantee of respondent Nos. 2 and 3. Respondent No. 1 executed a demand promissory note and also executed term agreement of hypothecation of the vehicle. The loan carried interest at the rate of 11% per annum with quarterly rests. The total outstanding inclusive of the interest charged as per agreement was Rs. 1,51,825 on the date the petitioner-bank filed a suit for recovery. The trial court passed a decree for Rs. 1,51,825 with future interest at the rate of 8% per annum from the date of the suit till realisation. An appeal preferred by the Bank before the High Court was partly allowed modifying the decree of the trial court by awarding interest at the rate of 11% per annum. However, the High Court directed the interest at the rate of 11% per annum to be payable only on Rs. 99,000, which was stated to be the principal sum, from the date of the suit till realisation though the decree for Rs. 1,51,825, the amount due and payable on the date of the suit, was maintained. Hence this appeal.

The following question arose before the Court:

What is the meaning to be assigned to the phrases "the principal sum adjudged" and "such principal sum" as occurring in Section 34(1) of the Code of Civil Procedure, 1908 [as amended by the Code of Civil Procedure (Amendment) Act (66 of 1956) w.e.f. 1.1.1957], a question of frequent recurrence and having far reaching implications in suits for recovery of money,

specially those filed by banking institutions against their borrowers? A

Disposing of the appeal, the Court

HELD : 1. There is nothing wrong in the parties voluntarily entering into transactions, evidenced by deeds incorporating covenant or stipulation for payment of compound interest at reasonable rates, and authorising the creditor to capitalise the interest on remaining unpaid so as to enable interest being charged at the agreed rate on the interest component of the capitalised sum for the succeeding period. Interest once capitalised, sheds its colour of being interest and becomes a part of principal so as to bind the debtor/borrower. [351-C-D] B C

2. Though interest can be capitalised on the analogy that the interest falling due on the accrued date and remaining unpaid, partakes the character 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. [362-C] D

3. Novation, that is, a debtor entering into a fresh agreement with creditor undertaking payment of previously borrowed principal amount coupled with interest by treating the sum total as principal, any contract express or implied and an express acknowledgment of accounts, are best evidence of capitalisation. Acquiescence in the method of accounting adopted by the creditor and brought to the knowledge of the debtor may also enable interest being converted into principal. A mere failure to protest is not acquiescence. [362-D-E] E F

4. The prevalence of banking practice legitimatises stipulations as to interest on periodical rests and their capitalisation being incorporated in contracts. Such stipulations incorporated in contracts voluntarily entered into and binding on the parties shall govern the substantive rights and obligations of the parties as to recovery and payment of interest. [362-F] G

5. Capitalisation method is founded on the principle that the borrower failed to make the payment though he could have made and thereby rendered himself a defaulter. To hold an amount debited to the account of the H

A borrower capitalised it should appear that the borrower had an opportunity of making the payment on the date of entry or within a reasonable time or period of grace from the date of debit entry or the amount falling due and thereby avoiding capitalisation. Any debit entry in the account of the borrower and claimed to have been capitalised so as to form an amalgam of the B principal sum may be excluded on being show to the satisfaction of the Court that such debit entry was not brought to the notice of the borrower and/or he did not have the opportunity of making the payment before capitalisation thereby excluding its capitalisation. [362-G-H; 363-A]

6. The power conferred by Sections 21 and 35-A of the Banking C Regulations Act, 1935 is coupled with duty to act. Reserve Bank of India is prime banking institution of the country entrusted with a supervisory role over banking and conferred with the authority of issuing binding directions having statutory force, in the interest of public in general and preventing banking affairs from deterioration and prejudice as also to secure D the proper management of any banking company generally. Reserve Bank of India is one of the watchdogs of finance and economy of the nation. It is, and it ought to be, aware of all relevant factors, including credit conditions as prevailing, which would invite its policy decisions. RBI has been issuing directions/circulars from time to time which *inter alia*, deal with rate of E interest which can be charged and the period at the end of which rests can be struck down, interest calculated thereon and charged and capitalised. It should continue to issue such directives. Its circulars shall bind those who fall within the net of such directives. For such transaction which are not squarely governed by such circulars, the RBI directives may be treated as F standards for the purpose of deciding whether the interest charged is excessive, usurious or opposed to public policy. [363-D-E]

7. Agricultural borrowings are to be treated on a pedestal different from others. Charging and capitalisation of interest on agricultural loans cannot be permitted in India except on annual or six monthly rests de- G pending on the rotation of crops in the area to which the agriculturist borrowers belong. [363-E]

8. Any interest charged and/or capitalised in violation of RBI directives, as to rate of interest, or as to period at which rests can be arrived at, H shall be disallowed and/or excluded from capital sum and be treated only

as interest and dealt with accordingly. [363-F] A

9. Award of interest *pendente lite* and post-decree is discretionary with the Court as it is essentially governed by Section 34 of the Code of Civil Procedure, 1908 *de hors* the contract between the parties. In a given case if the Court finds that in the principal sum adjudged on the date of the suit the component of interest is disproportionate with the component of the principal sum actually advanced the Court may exercise its discretion in awarding interest *pendente lite* and post-decree interest at a lower rate or may even decline awarding such interest. The discretion shall be exercised fairly, judiciously and for reasons and not in an arbitrary or fanciful manner. [363-G-H; 364-A] B C

10.1. A construction, which leads to repugnancy or inconsistency, has to be avoided. Ordinarily, a word or expression used at several places on one enactment should be assigned the same meaning so as to avoid "a head-on clash" between two meanings assigned to the same word or expression occurring at two places in the same enactment. It should not be lightly assumed that "Parliament had given with one hand what it took away with the other". That construction is to be rejected which will introduce uncertainly, friction or confusion into the working of the system. While embarking upon interpretation of words and expressions used in a Statute it is possible to find a situation when the same word or expression may have somewhat different meaning at different places depending on the subject or context. This is, however, an exception, which can be resorted to only in the event of repugnancy in the subject or context being spelt out. [355-C-E] D E F

Farrel v. *Alexander*, **[1976] 2 All E.R. 721, referred to.**

G.P. Singh; Principles of Statutory Interpretation, **7th Edn. 1999, pp. 113 and 119, referred to.**

10.2. The Court having accepted invitation to embark upon interpretative expedition shall identify on its radar the contextual use of the word or expression and then determine its direction avoiding collision with icebergs of inconsistency and repugnancy. [355-G] G

11.1. The use of the word "such" as an adjective prefixed to a noun is H

A **indicative of the draftsman's intention that he is assigning the same meaning or characteristic to the noun as has been previously indicated or that he is referring to something which has been said before. This principle has all the more vigorous application when the two places employing the same expression, at earlier place the expression having been defined or characterised and at the latter place having been qualified by use of the word "such", are situated in close proximity. [356-C]**

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New Webster's Dictionary And Thesaurus, **referred to.**

11.2. The meaning assigned to the expression 'the principal sum adjudged' should continue to be assigned to 'principal sum' at such other places in Section 34(1) CPC where the expression has been used qualified by the adjective "such", that is to say, as "such principal sum". [356-D]

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12. It is expected henceforth from the banks, bound by the directives of the Reserve Bank of India, to make an averment in the plaint that interest/compound interest has been charged at such rates, and capitalised at such periodical rests, as are permitted by, and do not run counter to, the directives of the Reserve Bank of India. A statement of account shall be filed in Court showing details and giving particulars of debit entries, and if debit entry relates to interest then setting out also the rate of, and if the period for which, the interest has been charged. On the Court being *prima facie* satisfied, if a dispute is raised in that regard, of the permissibility of debits, the onus would be on the borrower to show why the amount of debit balance appearing at the foot of the account and claimed as principal sum cannot be so accepted and adjudged. This practice would narrow down the scope of controversy in suits filed by banking institutions and enable an expeditious disposal of the suits, the issues wherein are by and large capable of being determined by documentary evidence. RBI directives have not only statutory flavour, but also any contravention thereof or any default in compliance therewith is punishable under Section 46(4) of the Banking Regulations Act, 1949. The Court can act on the assumption that transactions or dealings have taken place and accounts maintained by banks in conformity with RBI directives. [364-B-E]

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13. The reference is answered in the following terms :

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(a) Subject to a binding stipulation contained in a voluntary contract

between the parties and/or an established practice or usage interest on loans and advances may be charged on periodical rests and also capitalised on remaining unpaid. The principal sum actually advanced coupled with the interest on periodical rest so capitalised is capable of being adjudged as principal sum on the date of suit.

(b) The principal sum so adjudged is "such principal sum" within the meaning of Section 34(1) CPC on which interest *pendente lite* and future interest i.e. post-decree interest, at such rate and for such period, which the Court may deem fit, may be awarded by the Court. [364-H; 365-A-B]

Corporation Bank **v.** *H.S. Gowda*, **[1994] 5 SCC 213 and** *Bank of Baroda* **v.** *Jagannath Pigment & Chems*, **[1996] 5 SCC 280, affirmed.**

Pestonji Majoo **v.** *Gangadhar Khomka*, **[1969] 1 SCC 220;** *M.V. Mahalinga Aiyar* **v.** *Union Bank Ltd.*, **AIR (1943) Mad 216;** *I.K. Merchants Ltd.* **v.** *Indira Prakash Karnani*, **AIR (1973) Cal 306;** *D.S. Gowda* **v.** *M/s. Corporation Bank Ltd.*, **AIR (1983) Kar 143;** *Union Bank of India* **v.** *Gaurishankar Upadyay*, **AIR (1992) Bom 482;** *Gujarat Agro Oil Enterprises Ltd.* **v.** *Arvind H. Pathak*, **AIR Guj. 47;** *Indian Bank* **v.** *P. Venkata Satyavathi*, **(1993) 1 AWR 607;** *Ramshree Chandrakav* **v.** *Dena Bank*, **(1994) MPLJ 610 and** *Punjab National Bank v. Surinder Singh Mandyal*, **AIR (1996) HP 1, held inapplicable.**

Shiv Kissen Bhattar **v.** *CIT*, **[1973] 4 SCC 115;** *Corporation Bank* **v.** *D.S. Gowda*, **[1994] 5 SCC 213;** *Renusagar Power Co. Ltd.* **v.** *General Electric Co.*, **[1994] Supp. 1 SCC 644;** *Secretary, Irrigation Department, Government of Orissa* **v.** *G.C. Roy*, **[1992] 1 SCC 508;** *Dr. Shamlal Narula* **v.** *CIT*, **[1964] 7 SCR 668;** *State Bank of India, Bhubaneswar* **v.** *Ganjam District Tractor Owner's Association*, **[1994] 5 SCC 238;** *Jaffar Hussain* **v.** *Bishambhar Nath*, **AIR (1937) All 442,** *Chotey Lal* **v.** *Mohammad Ahmad Ali Khan*, **AIR (1933) Oudh 128;** *Rajendra Bhadur Singh* **v.** *Raghubir Singh*, **AIR (1934) Oudh 473;** *Pazhaniappa Mudaliar* **v.** *Narayana Ayyar*, **AIR (1943) Mad 157;** *Palai Central Bank Ltd.* **v.** *C. Ramaswami Nadar*, **AIR (1959) Ker 194;** *Thandamma* **v.** *Kuriakore Putherichal Iype*, **AIR (1962) Ker 235;** *K. Appa Rao* **v.** *V.L. Varadaraj*, **AIR (1981) Mad 94,** *Syndicate Bank* **v.** *M/s. West Bengal Cements Ltd.*, **AIR (1989) Del 107;** *Sigappiachi* **v.** *M.A.P.A. Palaniappa Chettiar*, **AIR (1972) Mad 463;** *Kalyanpur Cold Storage* **v.** *Sohanlal Bajpai*, **AIR (1990) All 218;** *Indian Bank* **v.** *M/s. Kamalalaya Cloth Store*, **AIR (1991)**

A **Ori 44;** *State Bank of India* **v.** *Advar Singh Saih*, **AIR (1986) P & H 381;** *Nedungadi Bank Ltd.* **v.** *M/s. Aswathi Starch and Glucose (P) Ltd.*, **AIR (1996) Ker 112,** *State Bank of India* **v.** *Smt. Neela Ashok Naik*, **AIR (2000) Bom 151;** *H.P. Krishna Reddy* **v.** *Canara Bank*, **AIR (1985) Kar 228,** *Bank of India* **v.** *Karnam Ranga Rao*, **AIR (1986) Kar 242;** *K.C. Venkateswarlu* **v.** *Syndicate* B *Bank*, **AIR (1986) AP 290;** *State Bank of India, Eluru, Re*, **AIR (1986) AP 291;** *Billamal* **v.** *Ahad Shah*, **AIR (1918) PC 249 and** *S.R.M.S. Chethambaram Chettiar* **v.** *Loo Thon Pao*, **AIR (1940) PC 60, referred to.**

Reddie **v.** *Williamson*, **[1863] 1 Macph (Ct. of Sess.) 228;** *Yourell* **v.** *Hibernian Bank Ltd.*, **[1918] SC 372;** *Commissioners of Inland Revenue* **v.** *Sir* C *H.C. Holder, Bt.* **[1931] 2 KB 81;** *Holder* **v.** *Inland Revenue Commissioners*, **[1932] All E.R. 265;** *Paton (Fenton's Trustee)* **v.** *Inland Revenue Commissioners*, **(1938) All E.R. 786;** *National Bank of Greece S.A.* **v.** *Pinios Shipping Co. No. 1*, **[1990] 1 AC 637;** *Lyle* **v.** *Chappel*, **[1932] 1 KB 691,** *Paton* **v.** *Inland Revenue Commissioners*, **[1938] AC 341;** *Carrington Ltd. Smith*, **[1906] 1 KB** D **79;** *Reading Trust* **v.** *Spero*, **[1930] 1 KB 492 and** *Riches* **v.** *Westminster Bank Ltd.*, **[1947] 1 All E.R. 469, referred to.**

Mulla : Code of Civil Procedure, **(1995 Edn.), Halsbury's Laws of England 4th Edn. Vo. 3 p. 118,** *Black's Law Dictionary* **7th Edn., referred to.**

E *Deutsche Bank* **v.** *Banque des Marchands de Moscou*, **4 L.D.B. 293, cited.**

CIVIL APPELLATE JURISDICTION : Special Leave Petition (C) No. 2421 of 1993.

F From the Judgment and Order dated 15.7.92 of the Bombay High Court in F.A. No. 227 of 1990.

WITH

C.A. Nos. 3964, 3967/92, S.L.P. (C) No. 3954/94, S.L.P.(C) No. 9082, G SLP (C) No. 9088/95, S.L.P. (C) No. 4562/98, C.A. No. 4716/94 and C.A. No. 2496 of 1993.

Harish N. Salve, Solicitor General, Rakesh Dwivedi, K.N. Bhat, Ranjit Kumar (AC), J.B. Dadachanji & Co., Janendra Lal, Ms. Yasmin Tarapore, Siddharth Goswami, Siddarth Choudhary, Ms. Aprajita Singh, Ms. Gayatri H Goswami, Prikesh Kapoor for Janendra Lal & Co., B.R. Narang, Amit P.

Deshpande, Balraj Dewan, V. Sudeer, Ugra Shankar Prasad, Rajiv Kapur, Ms. Shubhra Kapur, Sanjay Kapur, R.K. Kapoor, P. Verma for Anis Ahmad Khan, M.K. Dua, Ms. Nina Gupta, Uday Gupta, Ms. Arpita Mahajan, Vineet Kumar, K.M.K. Nair and A. Subba Rao (AC), Varun Goswami, R.C. Verma, Mukesh Verma, Ms. Madhu Moolchandani, Ms. Sushma Manchanda, Dhruv Mehta, Ms. Shobha, Ms. Anu Mehta, S.K. Mehta, Manoj Swarup, K.R. Nagarja, Shivaji M. Jadhav for the appearing parties.

Ex-parte for Respondent No. 4 in C.A. No. 4716/94.

The Judgment of the Court was delivered by

R.C. LAHOTI, J. What is the meaning to be assigned to the phrases "the principal sum adjudged" and "such principal sum" as occurring in Section 34 of the Code of Civil Procedure, 1908 [as amended by the Code of Civil Procedure (Amendment) Act (66 of 1956) w.e.f. 1.1.1957], a question of frequent recurrence and having far reaching implications in suits for recovery of money, specially those filed by banking institutions against their borrowers, has been referred by a three-Judge Bench of this court to the Constitution Bench.

It will be useful to reproduce the order of reference dated 7th May, 1996 (since reported as [1996] 5 SCC 279) so as to highlight the nature and scope of controversy arising for decision before the Constitution Bench:

"ORDER

After hearing learned Attorney General and *amicus curiae* Shri A. Subba Rao, Ranjit Kumar and K.M.K. Nair on (the interpretation of the provisions of Section 34 CPC on "the principal sum adjudged" the matter is required to be considered by a Constitution Bench. The learned Attorney General has drawn our attention to the judgments of this Court in *Corpn. Bank* v. *D.S. Gowda and Bank of Baroda* v. *Jagannath Pigment & Chem.*, wherein he sought to draw the deduction that the principal sum adjudged and the principal sum mentioned later would be the same. He seeks to take support from the word `such' in support of his contention. Preceding Amendment Act 66 of 1956, the words were "aggregate sum so adjudged" and after amendment, were substituted with the words "the principal sum adjudged", from the date

A of the suit to the date of the decree, in addition to any interest adjudged on such "principal sum" for any period prior to the institution of the suit (with further interest on such date as the court deems reasonable on the "principal sum")*. The distinction, therefore, was not drawn to the attention of this Court in the aforesaid two judgments in particular the later one. As a fact no argument in this behalf appears to have been canvassed. Interpretation of the liability of the borrower to pay interest on the principal sum to include interest that became merged with the principal sum adjudged or principal sum as lent, is required to be authoritatively laid down by a Bench of five Judges.

C The Registry is directed to place the matter before the Hon'ble the Chief Justice for constituting the Constitution Bench.

*[Sic., should have been — with further interest at such rate not exceeding six per cent per annum, as the Court deems reasonable on such 'principal sum', in our opinion]

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Section 34(1) of C.P.C. and 1956 Amendment

Sub-Section (1) of Section 34 abovesaid, as it stood prior to the 1956 amendment, and as it stands amended, are reproduced *in juxta* position hereunder :

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Prior to amendment	*As amended by Act No. 66 of 1956*
34. (1) Where and in so far as a decree is for the payment of money, the Court may, in the decree, order interest at such rate as the Court deems reasonable to be paid *on the principal sum adjudged*, from the date of the suit to the date of the decree, in addition to any interest adjudged *on such principal sum* for any period prior to the institution of the suit, (with further interest at such rate as the Court deems reasonable *on the aggregate sum so adjudged.*] from the date of the decree to the date of payment, or to such earlier date as the Court thinks fit.	(1) Where and in so far as a decree is for the payment of money, the Court may, in the decree, order interest at such rate as the Court deems reasonable to be paid *on the principal sum adjudged*, from the date of the suit to the date of the decree, in addition to any interest adjudged *on such principal sum* for any period prior to the institution of the suit, (with further interest at such rate not exceeding six per cent. per annum, as the Court deems reasonable *on such principal sum*,) from the date of the decree to the date of payment, or to such earlier date as the Court thinks fit.

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(2) Where such a decree is silent with respect to the payment of further interest on *such aggregate sum* as aforesaid from the date of the decree to the date of payment or other earlier date, the Court shall be deemed to have refused such interest, and a separate suit therefor shall not lie.	xxx xxx xxx xxx xxx (2) Where such a decree is silent with respect to the payment of further interest *on such principal sum* from the date of the decree to the date of payment or other earlier date, the Court shall be deemed to have refused such interest, and a separate suit therefor shall not lie.

(Underlining by us)

[Portions affected by amendment placed in bracket]

By the 1956 amendment, in Section 34, for the words "with further interest at such rate as the Court deems reasonable on the aggregate sum so adjudged", the words "with further interest at such rate not exceeding six percent, per annum as the Court deems reasonable on such principal sum" have been substituted in sub-section (1). In sub-section (2) the words "on such aggregate sum as aforesaid " have been deleted and the words "on such principal sum" have been substituted. The phrases "on the principal sum adjudged" and "such principal sum", as occurring in the opening part of sub-section (1) of Section 34, have not been touched by the amendment.

The report of the Joint Committee to which the Bill was referred stated, *inter alia*, as under :

> *"11. Clause 2.* — Section 34 of the Code empowers a Court to award further interest from the date of the decree upto the date of payment on the `aggregate sum' which comprises principal sum with interest accrued thereon. The Committee are of the opinion that interest should not be awarded on interest but only on the principal sum. Suitable amendment has accordingly been incorporated in this clause."

The controversy and contending pleas:

There is batch of matters before us wherein the same common question of law is arising for decision. Inasmuch we propose (also as has been agreed to by all the learned counsel appearing for the parties) to decide only the

A question of law posed for decision and leave the individual cases to be decided by appropriate Bench consistently with the law laid down by the Constitution Bench, we are relieved of the need of noticing facts of individual cases. Suffice it, for our purpose, to notice in very brief, by way of illustration, the facts of S.L.P. (C) No. 2421 of 1993 - *Central Bank of India* v. *Ravindra and Ors.* to B demonstrate the nature of controversy. The petitioner bank sanctioned a loan to the respondent no. 1 on the guarantee of respondents nos. 2 and 3. On 21.6.1979, the respondent no.1 executed a demand promissory note for Rs. 1,37,720 and also executed term agreement of hypothecation of the vehicle. The loan carried interest at the rate of 11% per annum with quarterly rests as on 31st March, 30th June, 30th September and 31st December every year. The C total outstanding, inclusive of the interest charged as per agreement, was Rs. 1,51,825 on the date of the suit for the recovery whereof the suit was filed by the petitioner bank. Relief was also prayed for the grant of interest *pendente lite* and future interest till realisation. The trial court passed a decree for Rs. 1,51,825 with future interest at the rate of 8% per annum from the date of the D suit till realisation affording the respondents facility of payment of the decretal amount in 6 quarterly instalments with exigibility clause. An appeal preferred by the bank before the High Court was partly allowed modifying the decree of the trial court by awarding interest at the rate of 11% per annum and setting aside the facility of payment by instalments. However, the High Court directed the interest at the rate of 11% per annum to be payable only on Rs. 99,000, E which was stated to be the principal sum, from the date of the suit till realisation though the decree for Rs. 1,51,825, the amount due and payable on the date of the suit, was maintained. The petitioner bank is aggrieved by the decree of the High Court to the extent to which future interest at the rate of 11% per annum has not been allowed on the entire sum of Rs. 1,51,825.

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We have heard Shri Harish N. Salve, learned Solicitor General appearing for Union of India, Shri Rakesh Dwivedi, Sr. Advocate appearing for State Bank of India and Shri K.N. Bhat, Sr. Advocate who has intervened on behalf of the Indian Banks Association as also other learned counsel appearing for several banks. We have also heard Shri Ranjit Kumar, Senior Advocate, the G learned *amicus* appointed to assist the Court who highlighted the legal position and judicial opinion clarifying by and large the fallacy — as per his submission — in the stand taken by the banks. Other learned counsel appearing for other borrowers were also heard.

H The learned Solicitor General submitted that the expression "the princi-

pal sum adjudged" used in Section 34 may have two meanings : (i) the amounts actually disbursed to the borrower, or (ii) the amount due from the borrower on the date of the suit which amount would include the amount of interest due and payable on the date of the institution of the suit in the Court. He made two submissions. First is the wider submission, as he named it, that whatever is the amount due and payable by the defendant on the date of the institution of the suit becomes `the principal sum adjudged' on which the judgment-debtor can be directed to pay interest *pendente lite* and for future. The learned Solicitor General however did not seriously press and pursue this wider submission and gave it up soon after projecting the same before the Court. However, he insistently pressed and pursued the second one, i.e. the narrower submission that `the principal sum adjudged' would include all sums as are due under the contract between the parties and have stood capitalised with the amount actually disbursed to the borrower. The amalgam — an intimate mixture — would be adjudged as the principal sum and would not permit any attempt at unscrambling. Developing the narrower argument further, the learned Solicitor General submitted that the contract between the parties or an established bank practice (in the case of banking transactions) may provide for the interest on periodical rests being compounded and capitalised with the principal, in which event, the amount debited in the account of the borrower shall shed its character as interest and become the principal on being capitalised and therefore shall have to be adjudged as `the principal sum' on the date of the suit. The contract or established banking practice shall govern the relationship between the parties and bind the Court. The Court will not reopen the account so as to separate from the amalgam — the interest charged and the sums actually advanced, and repaint the interest with the colour which had stood shed off unless mandate of law overrides the contract or practice and enables or compels the Court to do so. Any view to the contrary, if accepted, would be destructive of banking system which is functioning on a practice recognised for over a century over the world, submitted the learned Solicitor General.

The learned Solicitor General further submitted that the position of law remains the same in so far as the meaning of 'the principal sum adjudged' occurring in the first part of Section 34(1) is concerned and the principal sum so adjudged shall be the amount on which the Court shall award interest *pendente lite*, i.e., from the date of the suit to the date of the decree as also the future interest. In other words, submitted the learned Solicitor General, the Court shall adjudge the principal sum as it stands just anterior to the date of

A the suit consistently with the contract or banking practice binding the parties and once that is done 'the principal sum adjudged' shall be 'such principal sum' for the purpose of interest *pendente lite* as also future interest. So far as the 'interest adjudged' in addition to 'the principal sum adjudged' for any period prior to the institution of the suit is concerned, the learned Solicitor General B submitted, that there may be cases where interest prior to the date of the suit and included in the amount claimed by the plaintiff against the defendant on the date of the suit may consist of (i) such interest as has stood capitalised and hence become part of the principal sum, and (ii) such interest as has not been capitalised or was incapable of being capitalised, and the later would be C 'interest adjudged' in addition to the principal sum adjudged (which would be inclusive of interest capitalised) on the date of the institution of the suit. There may be cases where the total amount debited to the account of the debtor as interest has stood capitalised in its entirety in which case there may not be any sum of interest left and available to be treated as interest, other than the principal sum for the pre-suit period. The correct way of reading the opening D part of Section 34 would be - "the principal sum adjudged..... in addition to interest, *if any*, adjudged on such principal sum". 'Any interest adjudged on such principal sum' mean and should be read as 'interest *if any*, adjudged on such principal sum'. The learned Solicitor General went on to submit that the 1956 amendment does not have any bearing on the meaning E of words 'the principal sum adjudged' which remains the same pre and post 1956. The 1956 amendment, which has substituted the words "on such principal sum" for the words 'on the aggregate sum so adjudged' has only this effect that prior to the amendment future interest was capable of being awarded on the aggregate of three components taken together, i.e. (1) the principal sum F (so adjudged), (2) pre-suit interest (so adjudged), and (3) decretal costs. By virtue of 1956 amendment, the amount of interest *adjudged as interest* on the date of the suit and decretal costs cannot be ordered to carry future interest, but the amount adjudged as principal sum though inclusive of interest which has stood capitalised and has partaken character of principal by virtue of G contract or banking practice, is capable of bearing future interest because it will be 'the principal sum adjudged'.

Shri Ranjit Kumar, Senior Advocate, the learned *amicus* as also the other learned counsel appearing for the debtors have submitted that if the submission made by the learned Solicitor General is accepted it would defeat the legislative H intent behind the amendment as it would mean the Court awarding interest on

interest. It was submitted that without regard to the fact that the interest for the pre-suit period has stood capitalised by force of contract or banking practice between the parties, and has assumed the colour and character of principal sum, the contract or banking practice ceases to be applicable once the suit is filed and the matter has entered the domain of Court under Section 34 of the CPC. where after nothing prevents the Court from unscrambling the amalgam so as to sieve out the principal from interest and confine the award of interest *pendente lite* post decree to principal sum only.

Capitalisation of interest debited on periodical rests — does it convert interest into 'the principal sum'? — a survey of judicial opinion:

A host of authorities were cited at the Bar, throwing light on the issue at hand. It will be useful to have a survey thereof.

We would begin with the statement of law in *Reddie* v. *Williamson*, [1863] 1 Macph (Ct. of Sess.) 228, as we find that the law propounded therein has been referred to in a number of decisions rendered by the Court of Appeals, House of Lords, this Court and several High Courts. Lord Cowan said:

> "This account, from its origin, is kept in the usual mode of stating such accounts. It is balanced at the close of each year, and the periodical interest on advances accruing in the course of the year is placed to the debit side of the account, and to the extent of its amount the balance carried to the debit at the commencement of next year is increased. That amount is dealt with as a principal sum, on which interest is calculated, — the bank thereby securing, as they were entitled to do, interest on the accumulated amount each year, or, as it is generally stated, but not quite correctly, compound interest. The true view is, that the periodical interest at the end of each year is a debt to be then paid, and which must be held to have been paid when placed to the debit of the account as an additional advance by the bank for the convenience of the obligants." (at p. 238)

Lord Justice Clerk said :

> "The parties must of course have had in view that this account-current would be kept in the way, in which bankers always keep such accounts, balancing the account at the end of the year; and, in the event of the

A interest accruing during the past year not being otherwise paid or provided for, placing the amount of such interest as the last item to the debit of the account, and accumulating such interest along with the principal sum due on the account, and bringing down the balance thus ascertained, consisting partly of principal, and partly of interest, to the B new account for the ensuing year, and placing the accumulated balance as the first article of debit in that new account. Where an account is kept in this way consistently throughout its whole course, the interest thus accumulated with principal, at the end of each year not only becomes principal, but never thereafter ceases to be dealt with as C principal. " (at p. 236)

"The privilege of a banker to balance the account at the end of the year, and accumulate the interest with the principal, is founded on this plain ground of equity, that the interest ought then to be paid, and, because it is not paid, the debtor becomes thenceforth debtor in the amount, as D a principal sum itself bearing interest. This principle of equity must be consistently carried out in keeping an account on the bank's books, in which other parties are interested as obligants, besides the party operating on the account; and, if it be, then the moment that interest is thus converted into principal, the amount of it must be reckoned as part E of the drafts on the credit, or beyond the credit, for which the party operating on the account will be liable as principal in any event, ..." (at p.237)

In *Yourell & Anr.* v. *Hibernian Bank Ltd.*, [1918] AC 372, interest was charged from day to day with half yearly rests, so that the interest was F capitalised every half year in accordance with the terms of the deed which also contained ceiling on the principal sum which could be recoverable on the security. Lord Atkinson observed in his speech that whenever on balancing the mortgagor's current account with the bank a debit balance was found against him, that balance, by force of the covenant, *became part of the principal money* G *secured by the mortgage*, subject however, to the covenant limit. Lord Wrenbury opined that the interest upon the overdraft was capitalised half yearly and as against the bank the *capitalised interest must be regarded as principal* and hence the debit balance of the overdraft banking account was principal. In *Commissioners of Inland Revenue* v. *Sir H.C. Holder, Bt., & Anr.*, [1931] 2 KB H 81, the bank debited half yearly interest to the borrower's bank account on the

amount owing from time to time. It was held that the interest due each half year which, *upon the failure of the company to pay it,* was, according to the regular practice of bankers, *added to the capital sum advanced,* was thereby capitalised and *could not thereafter be treated as interest.* Lord Hanworth MR noted in his speech that the plan of capitalising interest at the end of each half year was adopted by bankers in order to enable them in effect to secure what is usually termed compound interest, which could not have otherwise been claimed by reason of the usury laws. Later his Lordship noted that under consideration was not the terms of a particular deed entered into between the parties but a practice which has been adopted by bankers for over a century, and which has had certain qualities attributed to it. Lord Romer concurring with Lord Hanworth opined that having regard to the method in which, with the concurrence of the company, the account was kept by the bank, the company must be deemed to have paid each half year the accruing interest by means of an advance made for this purpose by the bank to the company.

Holder & Anr. v. *Inland Revenue Commissioner*, [1932] All E.R. 265 and *Paton (Fenton's Trustee)* v. *Inland Revenue Commissioners*, [1938] All E.R. 786, are cases under the Income Tax Law. In *Holder's* case it was held that in view of the bank's practice of adding the interest each half-year to the amount advanced, the interest was in effect paid each half year to the bank by means of advances made for the purpose by the bank to the customer and for this reason no part payment (later) made by the tax payer was payment of interest and hence the tax payer was not entitled to the relief claimed. In *Paton's* case each half year interest at an agreed rate, and without deduction tax, was placed to the debit of the account of the borrower and the aggregate amount was then treated as principal for the following half year. Question arose, whether the interest in question which was capitalised could be said to have been in fact paid by the borrower so as to attract applicability to him of certain beneficial provision of the Income Tax Act, 1918? Lord Atkin opined — "The simple fact is that the amount of interest accruing during the half year is ascertained at the end of the half-year, and is added to the account as a debt in precisely the same position as the other debit items, whether for money lent, the price of securities bought, commission, or other source of debt. It takes its position as part of the whole debt due to the bank, and, as part of the whole debt, is in the next half-year chargeable with interest." His Lordship approved the view of Rusell, J. of Court of Appeal taking the view that because of a provision contained in the deed between the parties which enables the interest to be capitalised, the

A interest is not capitalised because it is in fact paid, but because it has in fact not been paid. Lord Macmillan opined — "It may well be that, in a question between a bank and its customer, and equally between a bank and its customer's cautioner, the interest accruing annually may, by the sanctioned method of accounting, cease to be interest when it is accumulated with the B principal, so that the bank can thereafter no longer sue for the interest as interest. ..... It is manifest, however, that it is only by a legal fiction that the interest in such cases as the present can be said to have been paid. After, as before, the striking of the balance, the same sum remains due, no longer, it may be, as interest, but still due as part of the principal debt. In construing the C extent of the cautioner's liability under the case credit bond, the court would appear to have been well-founded in their view that the bank's own method of accounting, assented to by the principal debtor, and recognised as ordinary practice, precluded any claim for past interest as interest prior to the last balance. The caution was liable for whatever was drawn upon the cash credit account up to £400, and the unpaid interest was debited in account just like the D ordinary drafts upon it, and became part of the principal debtor's capital indebtedness for which the cautioner was liable up to £400, with interest subsequent to the last balance."

In *National Bank of Greece S.A.* v. *Pinios Shipping Co. No. 1 & Anr.*, E [1990] 1 AC 637, House of Lords upheld the entitlement of the bank to the principal sum due to it, with interest thereon, as agreed, until payment or judgment in the usual way, and that the agreement included the term, implied by the usage of bankers, that the bank was entitled to capitalise interest which in the case before their Lordships was (by concession) at quarterly rests and F that such entitlement continued until judgment or payment. In the Court of Appeal, Lloyd LJ, who wrote the pending order, was of the opinion that an implied agreement to pay compound interest with quarterly rest based on the banking practice exists during the currency of the banker-customer relationship but once the banker-customer relationship ceases the bank cannot charge compound interest and only simple interest would be payable. His Lordship G traced the history of banking practice as borne out by judicial precedents, and held :

> "(i) There is no right to compound interest save by agreement, express or implied, or custom binding on the parties; (ii) there was no H express agreement to pay compound interest in the present case; (iii)

an agreement to pay compound interest may be implied by virtue of acquiescence (*Lord Ciancarly* v. *Latouche*), but (iv) such an agreement is not normally implied except as to "mercantile accounts current for mutual transactions" (Deutsche Bank v. Banque des Marchands de Moscou, 4 L.D.B. 293, 296, per Greer L.J.; (v) it is open to question whether the agreement between the bank and Pinios dated 8 February, 1977 was an account current for mutual transactions; but, even if it was, it ceased to be such an account when the bank closed the account and demanded repayment on 13 November 1978; (vi) the bank never pleaded or proved a custom entitling it to continue to charge compound interest after the account had been closed, or, a fortiori, after it had issued proceedings for the recovery of debt."

The bank appealed to the House of Lords. The House of Lords allowed the appeal and preferred by the bank and modified the judgment of the Court of Appeal by holding that no reason can be seen why that relationship should not be continued until repayment of the debt, or judgment, whichever first occurred, with the effect that, so long as the contractual interest was payable, the bank continued to be entitled to capitalise it. The House of Lords did not agree with the Court of Appeal that the relationship of banker and customer stood terminated by the bank's demand for payment.

In *Billamal* v. *Ahad Shah*, AIR (1918) PC 249, the Privy Council recognised the justification for adding on the accumulated interest under an earlier transaction in the fresh transaction and observed as under :

"A borrower who obtains a loan secured by a promissory note on quite reasonable terms, by neglecting to pay the note on maturity, further neglecting to pay the accruing interest for the several years following and then giving a renewal note for the original debt plus the capitalised interest, could produce a result which might at first sight appear oppressive, and yet there would be nothing harsh or unconscionable in the creditor's demand, *since the added interest only accumulated while he forebore to enforce the payment of the sums from time to time due to him.*"

S.R.M.S. Chethambaram Chettier v. *Loo Thon Poo*, AIR (1940) Privy Council 60, was a dispute between money lenders and borrowers arising from

A the State of Johore. Interest was charged @ 24% and was then capitalised and made payable by monthly instalments. Question arose whether the interest so charged was excessive and unfair. Their Lordships held that where a loan has been incurred for interest and this interest is added to the amount agreed to be due when a new transaction is agreed between the parties which includes that B payment of interest as an acknowledged debt this is not in principle open to any sound objection. Their Lordships referred to the decision of the Court of Appeal in *Lyle* v. *Chappel*, [1932] 1 KB 691, speech of Lord Atkin in *Paton* v. *Inland Revenue Commissioners*, [1938] AC 341, decision of Channel, J, in *Carrington Ltd.* v. *Smith*, [1906] 1 KB 79, and the decision by the Court of C Appeal in *Reading Trust* v. *Spero*, [1930] 1 KB 492, and held that a willing and intelligent borrower had agreed to the interest charged is one of the circumstances to be taken into account though not conclusive. Their Lordships upheld the charge of 15% interest payable on the sums from time to time acknowledge to be owing by the borrowers to the lenders and thus allowing interest on interest. However, interest charged @ 24% on the loan and charges D which were amply secured by charges on rubber estate which had been well looked after and kept in good order was held unreasonable, excessive and unfair. The fact remains that Their Lordships approved charging of interest @ 15% and capitalisation of the same by means of acknowledgment to that effect by the borrowers and also upheld permissibility of *further 15% interest being* E *charged on the sum so capitalised.*

It was pointed out in *Lyle* v. *Chappel*, (Supra, at p., 706) that it ought not to make any difference to the validity of a transaction by way of a renewal of a loan, whether the parties go through the form of payment by the borrower F of the whole amount due and a re-landing of the same amount by the money lender, or the transaction is carried out without any such payment by treating the amount of principal and interest still due as a debt acknowledged by the borrower together with an undertaking by the borrower to pay the amount of the agreed debt.

G *Jafar Husain* v. *Bishambhar Nath*, AIR 1937 Allahabad 442, was a case of recovery due on a mortgage and considered by reference to Order 34, Rule 11 of the Code of Civil Procedure. The words 'on the principal amount found or declared due on the mortgage' came up for the consideration of Division Bench. It was contended for the borrower that in calculating the amount due H to the mortgagee up to the date fixed for redemption, interest from the date of

the decree till the date fixed for redemption should be calculated on the principal sum secured by the deed and not on the total amount due on the date of the decree on account of principal as well as compound interest. The mortgage deed provided for interest being calculated six monthly and that if it was not paid then it would become a part of the principal. The Division Bench held that the words 'on the principal amount found or declared due' refer not only to the principal sum secured by the mortgage deed but also to the amount due on account of interest which has become a part of principal in accordance with the terms of the deed on the date when the preliminary decree is prepared. The Division Bench pointed out that reliance by the borrower on a ruling of the Oudh Chief Court in *Chotey Lal* v. *Mohammad Ahmad Ali Khan*, AIR (1933) Oudh 128, which appeared to be taking a view to the contrary was not good law inasmuch as a different view was taken by the same Court in *Rajendra Bahadur Singh* v. *Raghubir Singh*, AIR (1034) Oudh 473. In *Pazhaniappa Mudaliar and Ors.* v. *Narayana Ayyar and Ors.*, AIR (1943) Madras 157, the mode of dealing adopted by the parties was what is usually followed between banker and customer. The effect of the system is to capitalise the interest at the end of each year and treat it is a fresh advance by the bank. The Division Bench noted that according to the usage prevailing between bankers and customers, it is an implied term of their dealing that *the banker is to be treated as having made an advance to the customer at the end of each year or half year, as the case may be, of a sum equivalent in amount to the interest accruing during that period*, so as to enable the customer to discharge the interest, increasing the principal of his debt by a corresponding amount. It was urged that the periodical settlement of accounts evidenced by the borrower's letter of acknowledgment were renewals and only the sums advanced as principal were repayable notwithstanding its capitalisation of interest from time to time the interest being still treated as interest and wiped out. The Division Bench speaking through Patanjali Sastri, J. (as his Lordship then was) noted that if the effect of the mode of dealing adopted between banker and customer is according to the long standing usage governing their relations, to treat the interest accruing in any year as *discharged by a borrowing of an equivalent sum from the bank* in precisely the same way *as if the customer had given the bank a cheque upon the account* for the amount in question with which the bank extinguished the interest and *then placed the amount of the cheque to the debit of the account as an ordinary draft.*" it is difficult to see how the operation of this principle is affected by anything contained in the explanation to be found in the relevant provision of Madras Agriculturists' Relief Act, 1938 which

A B C D E F G H

merely provides that in cases of renewal of the debt, the sums advanced as principal shall alone be treated as the principal sum repayable by the agriculturists; for, the interest of the previous year is, under the rule, discharged, and the corresponding increase in the indebtedness of the customer is treated as a principal sum advanced by the bank.

Two decisions by Kerala High Court may now be noticed. *Palai Central Bank Ltd. v. C. Ramaswami Nadar,* AIR 1959 Kerala 194, is a Division Bench decision which noticed a line of Full Bench decisions of the Travancore High Court taking the view that when the agreement between the parties to a litigation sanctioned arrears of interest remaining unpaid for any specified period being treated as principal, the principal amount sued for within the meaning of the concerned provision would be the amount claimed in the plaint as principal on that basis. It was held that the terms 'principal' used in Section 31 of Travancore Civil Procedure Code (8 of 1100) is not restricted in its meaning to the original sum lent and that an agreement to treat arrears of interest, at fixed periods, as principal, which is to carry interest, is valid. It was further held that *the word 'principal amount' are not restricted to the original sum lent but are comprehensive to include arrears of interest, on which interest is agreed to be paid. Trandamma and Ors.* v. *Kuriakore Patherichal Iype,* AIR (1962) Kerala 235, is Full Bench decision which, though did not notice the Division Bench decision in *Palai Central Bank Limited* (supra), laid down the same law. An overdraft agreement entered into by the defendants with the plaintiff bank provided that the interest at 7 1/2% as agreed upon will be calculated quarterly, four times every year, and added to the principal. On the balance shown as due on 31.12.1952 in the account maintained by the Bank in pursuance of such agreement, the suit was filed for recovery of the amount due on 31.12.1952 as principal with future interest till the date of the suit. It was held that the effect of the agreement was to wipe off all interest outstanding at the end of each quarter by means of *further advances from the bank of similar amounts* which are debited to the account of the debtor. It was further held that the interest that thus accumulated with principal at the end of each quarter became principal and *never thereafter ceased to be dealt with as principal. The amount due on 31.12.1952 in the account* was treated *as the principal amount* outstanding on 1.11.1953. However, in passing the Full Bench noted that the position may have been different if under a local debt relief law it was subsequently provided that the principal would mean the amount originally advanced together with sum, if any subsequently advanced, notwithstanding any

stipulation to treat any interest as principal. A

In *K. Appa Rao* v. *V.L. Varadaraj & Ors.* AIR (1981) Madras 94, the Division Bench, speaking through Nainar Sundram, J., pointed out that the charging of compound interest by itself is not per se usurious except in the case of an agriculturist protected by the Usurious Loans Act, 1981 as amended in its application in Madras. However, the Division Bench, by reference to an earlier decision of that High Court, pointed out that for the purpose of determining whether interest would be excessive or not the risk incurred by the creditor by advancing the loan (whether it was secured or not and if secured to what extent) and if compound interest is charged, the periods at which it is calculated and the total advantage which may be reasonably excepted to have accrued from the transaction, are important factors. B C

In *Syndicate Bank* v. *M/s. West Bengal Cements Limited and Ors.*, AIR (1989) Delhi 107, Y.K. Sabharwal, J. (as his Lordship then was) rejected the contention of learned counsel for the borrower that the interest can never become principal and the words 'principal sum' in Section 34, Code of Civil Procedure should be given the ordinary meaning as given in the dictionaries, and termed as misconceived the argument that the interest under section 34 could be awarded only on the original sum advanced as the argument ran counter to the normal banking practice, and which, if accepted, would act as a premium for those not paying the amount of interest when it is due at the cost of those making payment of interest when it is due. It was held that the bank was entitled to the sum claimed as due from and payable by the defendants as the principal sum with future interest on such amount from the date of suit to the date of realisation. Reliance was placed on Division Bench decision of Madras High Court in *Sigappiachi* v. *M.A.P.A. Palaniappa Chettiar*, AIR (1972) Madras 463, holding that the 'principal sum adjudged' (within the meaning of Section 34 of the Code of Civil Procedure) is the amount found due as on the date of the suit. D E F

Division Bench decision in *Kalyanpur Cold Storage, Kalyanpur and Ors.* v. *Sohanlal Bajpai (deceased by L.Rs.) and Anr.*, AIR (1990) Allahabad 218, and Single Bench decision in *Indian Bank* v. *M/s. Kamalalaya Cloth Store and Anr.*, AIR (1991) Orissa 44, have taken the view, though they do not contain any elaborate reasoning, that under Section 34 of the Code of Civil Procedure the expression 'principal sum adjudged' is to be distinguished from G H

A principal sum advanced. The Orissa High Court has followed the Delhi decision above said. It was a case of commercial loan. The amount of interest quarterly added to the amount of loan was held entitled as principal amount on the date of the suit for the purpose of future interest.

B In *State Bank of India* v. *Advar Singh Saih and Ors.*, AIR (1986) Punjab & Haryana 381, while rejecting the borrower's application under Order 6, Rule 5 of the Code of Civil Procedure seeking direction to the bank to point out separately by breaking up its claim so as to show the amount of the principal and the interest separately, it was held that the principal amount found due not only means the principal amount but also the amount due as interest which has C become part of the principal.

In *Nedungadi Bank Ltd.* v. *M/s. Aswathi Starch and Glucose (P) Ltd., Anamangad & Ors.*, AIR (1996) Kerala 112, K.G. Balakrishnan, J. (as his Lordship then was), speaking for the Division Bench, held that the expression D "principal sum adjudged" used in Section 34 indicates that it is not the original principal amount but it could be an amount so adjudged as principal. If, as per the contract between the parties, interest also is to be treated as principal, the amount so adjudged is to be taken as principal for granting future interest.

E In *State Bank of India* v. *Smt. Neela Ashok Naik & Anr.*, AIR (2000) Bombay 151, Y.K. Sabharwal, C.J. (as his Lordship then was) speaking for the Division Bench, dealing with Section 34 of the Civil Procedure Code, held that legal position clearly was that the principal sum adjudged' can include in it interest as well, depending upon the contract between the parties. The contract for payment of interest with quarterly rests resulted into the interest being F capitalised so as to make sum total of the principal advanced plus interest accrued thereon "principal sum adjudged" on the date of the suit, the expression as employed under Section 34.

In *Shew Kissen Bhattar* v. *The Commissioner of Income Tax, Calcutta*, G [1973] 4 SCC 115, this Court has observed that on failure of the borrower to pay in accordance with the terms of the contract he is liable to pay compound interest. In other words, if he fails to pay interest in accordance with the contract, he is liable to pay interest on interest. To put it differently, *when the interest payable is not paid, the same becomes a part of the principal and* H *thereafter interest has to be paid not only on the original principal but also on*

that part of the interest which had become a part of the principal.

In *Corporation Bank* v. *D. S. Gowda & Anr.*, [1994] 5 SCC 213 a batch of appeals against three decisions of Karnataka High Court [reported as *D.S. Gowda* v. *Corporation Bank*, AIR (1983) Karnataka 143, *H.P. Krishna Reddy* v. *Canara Bank*, AIR (1985) Karnataka 228 and *Bank of India* v. *Karnam Ranga Rao and Ors.*, AIR (1986) Karnataka 242] were disposed of and while doing so two decisions of Andhra Pradesh High Court, namely, *K.C. Venkateswarlu* v. *Syndicate Bank*, AIR (1986) AP 290 and *State Bank of India, Eluru*, Re, AIR (1986) AP 291, where also noticed and dealt with *D.S. Gowda's* case was of a commercial advance taken by the borrower for the purpose of constructing residential flats on a building site allotted by Bangalore Development Authority. Interest at the rate of 16.5% per annum, with quarterly rests, was charged. Interest, penal interest and service charges were debited to the account and capitalised. In the cases of *H.P. Krishna Reddy*, (supra) and *Karnam Ranga Rao* (supra), loans were advanced for agricultural purposes. Directions made by Reserve Bank of India were violated and the interest was charged at rates far excess of the limits prescribed by the Reserve Bank, also by compounding at quarterly rests, not permitted by Reserve Bank. One of the questions having a bearing on the day to day transactions of loan/advance entered into by the banks was: Whether the bank is entitled to claim interest with periodical rests, e.g., a monthly rest, a quarterly rest, a six-monthly rest, or a yearly rest, or compound interest in any other manner, from a borrower who has obtained a loan or an advance for agricultural/commercial purposes, as the case may be? During the course of its judgment the Court observed (vide para 14) :-

> "..... charging of interest with periodical rests or compounding of interest would be allowed if there is evidence of the customer having acquiesced therein, provided the relation of banker and customer is subsisting. However, if the relationship undergoes a change into that of mortgagee and mortgagor by the taking of a mortgage, the charging of interest would be governed in accordance with the terms of the mortgage. The taking of a mortgage to secure the fluctuating balance of an overdrawn account, being not inconsistent with the relationship of banker and customer, would not displace an earlier right to charge compound interest. Thus, the practice of bankers to debit the accrued interest to the borrower's current account at regular periods is a

A recognised practice."

Their Lordships cited with approval the following passage from Halsbury's Laws of England (4th Edition) (Vol. 3, at page 118, para 160) :-

B "*160. Interest.* By the universal custom of bankers, a banker has the right to charge simple interest at a reasonable rate on all overdrafts. An unusual rate of interest, interest with periodical rests, or compound interest can only be justified, in the absence of express agreement, where the customer is shown or must be taken to have acquiesced in the account being kept on that basis. Whether such acquiescence can C be assumed from his failure to protest at an interest entry in his statement of account is doubtful.

Acquiescence in such charges only justifies them so long as the relation of banker and customer exists with respect to the advance. If D the relation is altered into that of mortgagee and mortgagor by the taking of a mortgage, interest must be calculated according to the terms of the mortgage, or according to the new relation.

The taking of a mortgage to secure a fluctuating balance of an overdrawn account, is not, however, inconsistent with the relation of E a banker and customer, so as to displace a previously accrued right to charge compound interest.

It is the practice of bankers to debit the accrued interest to the borrower's current account at regular periods (usually half-yearly); F where the current account is overdrawn or becomes overdrawn as the result of the debit *the effect is to add the interest to the principal, in which case it loses its quality of interest and becomes capital.*"

Their Lordships reversed the judgment of the Karnataka High Court which was under appeal and approved and affirmed view of the same High G Court in *H.P. Krishna Reddy* v. *Canara Bank*, AIR (1985) Karnataka 228, and *Bank of India* v. *Karnam Ranga Rao*, AIR (1986) Karnataka 242. Universal banking practice of usually charging interest on periodical rests and compounding interest on remaining unpaid was specifically dealt with and approved. The principle relevant consideration which prevailed with the H Court were : continuing judicial upholding of such practice over a length

of time and the Reserve Bank of India by issuing circulars/directives from time to time and on paying 'adequate attention' having accorded its approval to permissibility of such practice but intervening in the interest of streamlining the same. A

Bank of Baroda v. *Jagannath Pigment & Chemicals & Ors.*, (Civil Appeal No. 2785/1987) decided on September 21, 1994 [see [1996] 5 SCC, at p. 280] is a short judgment delivered by three-Judge Bench of this Court approving the two-Judge Bench decision of this Court in *Corporation Bank* (supra). Therein the sum borrower by the debtor was Rs. 1,20,675.59p to which compound interest was added and a suit to recover a sum of Rs. 1,66,759.29p. with interest was filed claiming that the interest charged and added to the sum borrowed would be the principal sum adjudged on which future interest could be granted under section 34 of the Civil Procedure Code. This plea found favour with the Trial Judge. On appeal the High Court modified the decree by directing that future interest should be calculated on the sum borrowed viz. Rs. 1,20,675.59 and not the principal sum adjudged i.e. Rs. 1,66,759.29. This Court set aside the appellate judgement of the High Court and restored the decree passed by the Trial Judge. B C D

In *Renusagar Power Co. Ltd. v. General Electric Co.*, [1994] Supp. 1 SCC 644, pp. 89-93 a three-Judge Bench of this Court has noted the practice of charging interest as prevalent in Australia, Canada and India and held that compound interest can be awarded by Courts in India when justice so demands and is not to be regarded as being against public policy. The Court noted that it is a common knowledge that provision is made for the payment of compound interest in contracts for loans advanced by banks and financial institutions and such contracts are enforced by Courts. E F

Shri Ranjit Kumar, the learned *amicus* brought to the notice of the Court a few decisions taking the view that under Section 34 of the CPC principal sum has to be read as consisting of the amounts *actually advanced* and hence the Court must unscramble the amalgam and *segregate* such *principal sum* from the amount of *interest compounded and capitalised* and confine award of interest *pendente lite* and post-decree only to such principal sum. He referred to *Soli Pestonji Majoo & Ors.* v. *Gangadhar Khomka*, [1969] 1 SCC 220; *M.V. Mahalinga Aiyar* v. *Union Bank Ltd., Kumbakonam*, AIR (1943) Madras 216; *I.K. Merchants Ltd.* v. *Indra Prakash Karnani*, AIR (1973) Calcutta 306; *D.S.* G H

A *Gowda* v. *M/s. Corporation Bank*, AIR (1983) Karnataka 143; *Union Bank of India* v. *Gaurishankar Upadyay*, AIR (1992) Bombay 482; *Gujarat Agro Oil Enterprises Ltd. Ahmedabad* v. *Arvind H. Pathak*, AIR (1993) Gujarat 47, *Indian Bank, rep. by the Zonal Manager, Hyderabad* v. *P. Venkata Satyavathi & Ors.*, (1993) 1 Andhra Weekly Reports 607, *Ramashree Chandrakar* v. B *Dena Bank & Anr.*, (1994) MPLJ 610 and *Punjab National Bank* v. *Surinder Singh Mandyal & Ors.*, AIR (1996) HP 1. Obviously he could not have multiplied the authorities which are bound to be few being not in line with the weight of the judicial authority which we have already dealt with. Having gone through all the cited rulings we are of the opinion that no dent results in the C view we are taking.

Soli Pestonji Majoo & Ors.'s case decided by this Court was a case of mortgage decided by reference to Order 34 of the C.P.C. wherein it was held that till the period for redemption expired, the matter was in domain of contract but after the period of redemption the matter passed to that of judgment. Vide D para 5, the Court has said that the special provision of Order 34 would apply in preference to the general provisions in Section 34 in the case of mortgage. Clearly this Court has not laid down any principle dealing with Section 34 of the C.P.C.. In *M.V. Mahaling Aiyar's* case Division Bench of Madras High Court has not dealt with the principle of capitalisation. The case has no rel- E evance for the issue at hand. Full Bench decision of Bombay High Court in *Union Bank of India* v. *Gaurishankar Upadyay* proceeds on the assumption that *the 'principal sum' can never include interest* whatever be the agreement between the parties and this hypothesis is itself incorrect as we have dealt with. The Full bench dissented from the view taken by a number of High Courts and F chose to follow a Division Bench decision of that very High Court in the case of *M/s. Jagannath Pigment & Chemicals* v. *Bank of Baroda*, which has been reversed by this Court (See - [1996] 5 SCC 279). *D.S. Gowda's* case of Karnataka High Court was also reversed by this Court. Himachal Pradesh, Madhya Pradesh, Andhra Pradesh and Punjab High Court decisions cited by G the learned *amicus*, are based on Bombay High Court Full Bench view. In *I.K. Merchants Ltd.'s* case, the learned single Judge of Calcutta High Court has not approved interest being awarded on the sum adjudged as interest for the pre-suit period (See, Para 31 of the Report). To the same effect is the Division Bench decision of Gujarat High Court in *Gujarat Agro's* case. These two H decisions have no relevance to the issue before us.

Conclusion which follows :

The English decisions and the decisions of this Court and almost all the High Courts of the country have noticed and approved long established banking practice of charging interest at reasonable rates on periodical rests and capitalising the same on remaining unpaid. Such a practice is prevalent and also recognised in non-banking money lending transactions. Legislature has stepped in from time to time to relieve the debtors from hardship whenever it has found the practice of charging compound interest and its capitalisation to be oppressive and hence needing to be curbed. The practice is permissible, legal and judicially upheld excepting when superseded by legislation. There is nothing wrong in the parties voluntarily entering into transactions, evidenced by deeds incorporating covenant or stipulation for payment of compound interest at reasonable rates, and authorising the creditor to capitalise the interest on remaining unpaid so as to enable interest being charged at the agreed rate on the interest component of the capitalised sum for the succeeding period. Interest once capitalised, sheds its colour of being interest and becomes a part of principal so as to bind the debtor/borrower.

Interest and its classes :

Black's Law Dictionary (7th Edition) defines 'interest' *inter alia* as the compensation fixed by agreement or allowed by law for the used or detention of money, or for the loss of money by one who is entitled to its use; especially, the amount owed to a lender in return for the use of the borrowed money. According to Stroud's Judicial Dictionary of Words and Phrases (5th edition) interest means, *inter alia*, compensation paid by the borrower to the lender for deprivation of the use of his money. In *Secretary, Irrigation Department, Government of Orissa & Ors.* v. *G.C. Roy*, [1992] 1 SCC 508, the Constitution Bench opined that a person deprived of the use of money to which he is legitimately entitled has a right to be compensated for the deprivation, call it by any name. It may be called interest, compensation or damages..... this is the principles of Section 34, Civil Procedure Code. In *Dr. Shamlal Narula* v. *C.I.T., Punjab*, [1964] 7 SCR 668, this Court held that interest is paid for the deprivation of the use of the money. The essence of interest in the opinion of Lord Wright, in *Riches* v. *Westminister Bank Ltd.*, [1947] 1 All ER 469, 472, is that it is a payment which becomes due because the creditor has not had his money at the due date. It may be regarded either as representing the profit he

might have made if he had had the use of the money, or, conversely, the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for the deprivation; the money due to creditor was not paid, or, in other words, was withheld from him by the debtor after the time when payment should have been made, in breach of his legal rights, and interest was a compensation whether the compensation was liquidated under an agreement or statute. A Division Bench of the High Court of Punjab speaking through Tek Chand, J. in *C.I.T., Punjab* v. *Dr. Shamlal Narula*, AIR (1963) Punjab 411 thus articulated the concept of interest - "the words "interest" and "compensation" are sometimes used interchangeably and on other occasions they have distinct connotation. "Interest" in general terms is the return or compensation for the use or retention by one person of a sum of money belonging to or owned to another. In its narrow sense,"interest" is understood to mean the amount which one has contracted to pay for use of borrowed money..... In whenever category "interest" in a particular case may be put, it is a consideration paid either for the use of money or for forbearance in demanding it, after it has fallen due, and thus, it is a charge for the use or forbearance of money. In this sense, it is a compensation allowed by law or fixed by parties, or permitted by custom or usage, for use of money, belonging to another, or for the delay in paying money after it has become payable." It is the appeal against this decision of Punjab High Court which was dismissed by Supreme Court in *Dr. Shamlal Narula's* case (supra).

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 penal action. Penal interest can be charged only once for one period of default and, therefore, cannot be permitted to be capitalised.

Mulla on the Code of Civil Procedure (1995 Edition) sets out three divisions of interest as dealt in Section 34 of CPC. The division is according to the period for which interest is allowed by the Court, namely - (1) interest accrued due prior to the institution of the suit on the principal sum adjudged; (2) additional interest on the principal sum adjudged, from the date of the suit

to the date of the decree, at such rate as the Court deems reasonable; (3) further interest on the principal sum adjudged, from the date of the decree to the date of the payment or to such earlier date as the Court thinks fit, at a rate not exceeding 6 per cent per annum. Popularly the three interests are called pre-suit interest, interest *pendente lite* and interest post-decree or future interest. Interest for the period anterior to institution of suit is not a matter of procedure; interest *pendente lite* is not a matter of substantive law (See, *Secretary, Irrigation Department, Government of Orissa & Ors.* v. *G.C. Roy*, [1992] 1 SCC 508, Pr. 44-iv). Pre-suit interest is referable to substantive law and can be sub-divided into two sub-heads; (i) where there is a stipulation for the payment of interest at a fixed rate; and (ii) where there is no such stipulation. If there is a stipulation for the rate of interst, the Court must allow that rate upto the date of the suit subject to three exceptions; (i) any provision of law applicable to money lending transactions, or usury laws or any other debt law governing the parties and having an overriding effect on any stipulation for payment of interest voluntarily entered into between the parties; (ii) if the rate is penal, the Court must award at such rate as it deems reasonable; (iii) even if the rate is not penal the Court may reduce it if the interest is excessive and the transaction was substantially unfair. If there is no express stipulation for payment of interest the plaintiff is not entitled to interest except on proof of mercantile usage, statutory right to interest, or an implied agreement. Interest from the date of suit to date of decree is in the discretion of the Court. Interest from the date of the decree to the date of payment or any other earlier date appointed by the Court is again in the discretion of the Court - to award or not to award as also the rate at which to award. These principles are well established and are not disputed by learned counsel for the parties. We have stated the same only by way of introduction to the main controversy before us which has a colour little different and somewhat complex. The learned counsel appearing before us are agreed that pre-suit interest is a matter of substantive law and a voluntary stipulation entered into between the parties for payment of interest would being the parties as also the Court excepting in any case out of the three exceptions set out hereinbefore.

"Such Principal Sum"—meaning of:

Let us paraphrase the relevant part of Section 34(1) as under and then deal with the question posed before us:

A "Where and in so far as a decree is for the payment of money, the Court may, in the decree, order interest at such rate as the Court deems reasonable to be paid *on the principal sum adjudged,*

from the date of the suit to the date of the decree,

B in addition to any interest adjudged on *such principal sum* for any period prior to the institution of the suit,

with further interest at such rate not exceeding six per cent per annum, as the Court deems reasonable on *such principal sum*, from the date of the decree to the date of payment, or to such earlier date as the C Court thinks fit."

A few points are clear from a bare reading of the provision. While decreeing a suit if the decree be for payment of money, the Court would adjudge the principal sum on the date of the suit. The Court may also be called D upon to adjudge interest due and payable by the defendant to the plaintiff for the pre-suit period which interest would, on the findings arrived at and noted by us hereinabove, obviously be other than such interest as has already stood capitalised and having shed its character as interest, has acquired the colour of the principal and having stood amalgamated in the principal sum would be E adjudged so. The principal sum adjudged would be the sum actually loaned plus the amount of interest on periodical rests which according to the contract between the parties or the established banking parties has stood capitalised. Interest *pendente lite* and future interest (i.e. interest post-decree not exceeding 6 per cent per annum) shall be awarded on such principal sum i.e. the principal F sum adjudged on the date of the suit. It is well settled that the use of the word 'may' in Section 34 confers a discretion on the Court to award or not to award interest or to award interest at such rate as it deems fit. Such interest, so far as future interest is concerned may commence from the date of the decree and may be made to stop running either with payment or with such earlier date as the Court thinks fit. Shortly hereinafter we propose to give an indication of the G circumstances in which the Court may decline award of interest or may award interest at a rate lesser than the permissible rate.

It was submitted by the learned amicus and other counsel for the borrowers, that the expression "on such principal sum" as occurring twice in the H latter part of Section 34(1), which refers to interest *pendente lite* and post-

decree, should be interpreted to mean principal sum arrived at by excluding the interest even if it has stood capitalised. This would be consistent with the legislative intent as reflected in the report of Joint Committee and sought to be fulfilled by 1956 Amendment. For two reasons this contention has to be rejected. Firstly, entertaining such a plea amounts to begging the question. As we have already held that the interest once capitalised ceases to be interest and becomes a part of principal sum or capital. That being so the interest forming amalgam with the principal, in view of having been capitalized, is principal sum and therefore the question of awarding interest on interest does not arise at all. Secondly, well-settled principles of interpretation of statutes would frown upon such a plea being entertained. A construction which leads to repugnancy or inconsistency has to be avoided. Ordinarily, a word or expression used at several places in one enactment should be assigned the same meaning so as to avoid "a head-on clash" between two meanings assigned to the same word or expression occurring at two places in the same enactment. It should not be lightly assumed that "Parliament had given with one hand what it took away with the other" [See - Principles of Statutory Interpretation, Justice G.P. Singh, 7th Edition 1999, p.113]. That construction is to be rejected which will introduce uncertainty, friction or confusion into the working of the system (ibid, p.119). While embarking upon interpretation of words and expressions used in a Statute it is possible to find a situation when the same word or expression may have somewhat different meaning at different places depending on the subject or context. This is however an exception which can be resorted to only in the event of repugnancy in the subject or context being spelled out. It has been the consistent view of Supreme Court that when the Legislature used same word or expression in different parts of the same section or statute, there is a presumption that the word is used in the same sense throughout. (ibib, p.263). More correct statement of the rule is, as held by House of Lords in *Farrell* v. *Alexander*, [1976] 2 All E.R. 721, 736, "where the draftsman uses the same word or phrase in similar contexts, he must be presumed to intend it in each place to bear the same meaning". The Court having accepted invitation to embark upon interpretative expedition shall identify on its radar the contextual use of the word or expression and then determine its direction avoiding collision with icebergs of inconsistency and repugnancy.

Webster defines "such" as "having the particular quality or character specified; certain; *representing the object as already particularised* in terms which are not mentioned. In New Webster's Dictionary And Thesaurus, mean-

A ing of "such" is given as "of a kind previously or about to be mentioned or implied; of the same quality as something just mentioned (used to avoid the repetition of one word twice in a sentence); of a degree or quantity stated or implicit; the same as something just mentioned (used to avoid repetition of one word twice in a sentence); that part of something just stated or about to be B stated." Thus, generally speaking, the use of the word "such" as an adjective prefixed to a noun is indicative of the draftsman's intention that he is assigning the same meaning or characteristic to the noun as has been previously indicated or that he is referring to something which has been said before. This principle has all the more vigorous application when the two places employing the same C expression, at earlier place the expression having been defined or characterised and at the latter place having been qualified by use of the word "such", are situated in close proximity.

We are of the opinion that the meaning assigned to the expression 'the principal sum adjudged' should continue to be assigned to "principal sum" at D such other places in Section 34(1) where the expression has been used qualified by the adjective "such'' that is to say, as "such principal sum". Recognition of the method of capitalisation of interest so as to make it a part of the principal consistently with the contract between the parties or established banking practice does not offend the sense of reason, justice and equity. As we have noticed E such a system has a long established practice and a series of judicial precedents upholding the same. Secondly, the underlying principle as noticed in several decided cases is that when interest is debited to the account of the borrower on periodical rests, it is debited because of its having fallen due on that day. Nothing prevents the borrower from paying the amount of interest on the date it falls due. If the amount of interest is paid there will be no occasion for F capitalising the amount of interest and converting it into principal. If the interest is not paid on the date due, from that date the creditor is deprived of such use of the money which it would have made if the debtor had paid the amount of interest on the date due. The creditor needs to be compensated for deprivation. As held in *Pazhaniappa Mudaliar and Ors.* v. *Narayana Ayyar* G *and Ors.* (supra) the fact-situation is analogous to one as if the creditor has advanced money to the borrower equivalent to the amount of interest debited. We are, therefore, of the opinion that the expression "the principal sum adjudged" may include the amount of interest, charged on periodical rests, and capitalised with the principal sum actually advanced, so as to become an H amalgam of principal in such cases where it is permissible or obligatory for the

Court to hold so. Where the principal sum (on the date of suit) has been so adjudged, the same shall be treated as "principal sum" for the purpose of "such principal sum" - the expression employed later in Section 34 of C.P.C.. The expression "principal sum" cannot be given different meanings at different places in the language of same section, i.e. Section 34 of C.P.C..

The 1956 amendment serves two-fold purpose. Firstly, it prevents award of interest on the amount of interest so adjudged on the date of suit. Secondly, it brings the last clause of Section 34, by narrowing down its ambit, in conformity with the scope of the first clause in so far as the expression "the principal sum adjudged" occurring in the first part of Section 34 is concerned which has been left untouched by amendment. The meaning to be assigned to this expression in the first part remains the same as it was even before the amendment. However, in the third part of Section 34 the words used were "on the aggregate sum so adjudged". The judicial opinion prevalent then was (to wit, see *Prabirendra Mohan* v. *Berhampore Bank Ltd. & Ors.*, AIR (1954) Calcutta 289, 295 that `aggregate sum' contemplated the aggregate of (i) the principal sum adjudged, (ii) the interest from the date of the suit to the date of decree, and (iii) the pre-suit interest. Future interest was capable of being awarded also on the amount of pre-suit interest - adjudged as such, that is, away from such interest as was adjudged as principal sum having amalgamated into in by virtue of capitalisation. The amendment is intended to deprive the court of its pre-amendment power to award interest on interest i.e. interest on interest adjudged as such. The amendment cannot be read as intending, expressly or by necessary implication, to deprive the court of its power to award future interest on the amount of the principal sum adjudged, the sense in which the expression was understood, also judicially expounded even before 1955; the expression having been left untouched by the 1956 amendment.

It was submitted from borrowers' side that such an interpretation of Section 34 of the Civil Procedure Code as canvassed on behalf of the banks, if accepted, may result in anomalous situations emerging. To wit, it was pointed out that if the bank deliberately and unscrupulously delays the suit being filed, for such period of delay the bank would gain an advantage by continuing to charge interest at the contract rate and by capitalising the same. If the suit was filed promptly then the contract would cease to operate and debtor would be relieved from the rigour of the contract and find solace under the operation of Section 34 of the Civil Procedure Code. True it is that once a suit is filed in the Court, so far as Section 34 of the Civil Procedure Code is concerned, the

A relationship of parties ceases to be governed by contract between the parties and comes to be governed by Section 34 of the Civil Procedure Code. Still the submission has to be repelled for several reasons. Firstly, the bank can afford to wait or delay the filing of the suit only during the period of limitation which delay would not be illegitimate. Secondly, noting prevents the debtor, even B during the period of this delay, to pay or tender the amount of interest as and when it falls due and thereby prevent its capitalisation. Thirdly, the court is not powerless to deny the bank's claim for interest, if in the facts and circumstances of a given case the court is persuaded to hold that filing of the suit was delayed for the purpose of deliberately gaining an unfair advantage over adverse financial condition of the defendant. In such cases the pre-suit interest though C claimed in accordance with the contract would be denied by the Court on the ground of public policy and on the ground of the creditor having tried to gain an unfair advantage over the debtor by a deliberate inaction of himself, no one can take advantage of its own wrong.

D It was further submitted that if the expression "the principal sum adjudged" was to be interpreted and assigned a meaning as inclusive of the interest capitalised and therefore being the principal sum to be adjudged so at the date of the suit then there would be left nothing to be adjudged by way of interest for the pre-suit period and therefore a part of Section 34(1) "and in addition to any interest adjudged on such principal sum for any period prior E to the institution of the suit" - shall be rendered redundant. We cannot subscribe to this submission. We give just an illustration or two to demonstrate reasons for our such opinion. The same plaintiff while suing the same defendant may join in the suit more causes of action then one; one permitting capitalisation of interst, and the other, not permitting the same. There may be a case, as was F *Gowda's* case decided by this Court, wherein interest is capitalised with quarterly rests on a particular date, says 31st March and so on and the suit is filed before the date on which interest will be capitalised. The amount of interest charged for the period of time less than the quarter would remain an interest, not capitalised. Then there may be a case where interest may have been charged and capitalised at a rate exceeding the one permitted in which case the amount G of interest charged and capitalised beyond the quantum permissible shall have to be separated. In all such cases the principal sum inclusive of capitalised interest to the extent permissible shall be adjudged as `principal sum' and there would also be `in addition any interest adjudged by way of interest on such principal sum' for the pre-suit period. We therefore find force in the submission H of the learned Solicitor General that in that part of Section 34(1) which speaks

of "interest adjudged on such principal sum" for pre-suit period, the text should be read as if by reading "interest" qualified by "if any" so as to make it meaningful.

It was also submitted that Section 34 of the CPC is general in its application to all money suits and if banking practice or banking contracts providing for capitalisation of interest charged on periodical rests were to be recognised it will mean that application of Section 34 would be different in suits filed by banks and in suits filed by creditors other than bankers. In our opinion it is bound to be so. Section 34 is a general procedural provision and whether it would apply or not and if apply then to what extent would obviously depend on the fact situation of each case.

We are, therefore, of the opinion that two-Judge Bench decision of this Court in *Corporation Bank* v. *D.S. Gowda & Anr.*, and three Judge Bench decision in *Bank of Baroda* v. *Jagannath Pigment & Chemicals & Ors.*, are correctly decided and are, therefore, affirmed. A creditor can charge interest from his debtor on periodical rests and also capitalise the same so as to make it a part of the principal. Such a course can be justified by stipulation in a contract voluntarily entered into between the parties or by a practice or usage well established in the world to which the parties belong. Such practice is to be found already in vogue in the field of banking business. Such contract or usage or practice can stand abrogated by legislation such as Usury Laws or Debt Relief Laws and so on.

A Few Notes of Caution:

Though we have answered the question of law before us, but we cannot leave the matter at that alone without sounding notes of caution, lest our view of the law should be misconstrued and misapplied. Before we do so, it would be appropriate to refer to the decision of this Court in *Corporation Bank* v. *D.S. Gowda* (supra) in somewhat details.

The Banking Regulations Act, 1949 empowers Reserve Bank, on its being satisfied that it is necessary or expedient in the public interest or in the interest of depositors or banking policy so to do, to determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular and when the policy has been so determined it has a binding effect. In particular, the Reserve Bank of India may give direc-

A tions as to the rate of interest and other terms and conditions on which advances or other financial accommodation may be made. Such directions are also binding on every banking company. Section 35A also empowers Reserve Bank of India in the public interest or in the interest of banking policy or in the interests of depositors (and so on) to issue directions generally or in particular B which shall be binding. With effect from 15.2.1984 Section 21A has been inserted in the Act which takes away power of the Court to re-open a transaction between a banking company and its debtor on the ground that the rate of interest charged is excessive. The provision has been given an overriding effect over the Usury Loans Act, 1918 and any other provincial law in force relating to indebtedness.

C

This Court held in *D.S. Gowda's* case that the directions issued by the Reserve Bank of India have statutory flavour. The Court noted that agricultural finance stands on a different footing for the reason that agriculturists do not have any regular source of income other than the sale proceeds of their crops D and therefore agricultural loans have to be treated differently from other loans and borrowings. Reserve Bank of India has also shown its concern towards agriculturist loances by devising separate policy to govern them and not permitting capitalisation of accrued interest on agricultural loans except on annual rests or when the loan/instalment has become overdue.

E As to capitalisation of interest charged on periodical rests this Court found the High Court of Karnataka having noticed that banks in India were not following a uniform practice and some banks charged interest with monthly or quarterly rests while others charged with yearly or six monthly rests and hence the Reserve Bank of India had to issue directives to bring about uniformity in F that behalf. In conclusion this Court held that if bank was claiming interest in excess of that permitted by the circular/direction of the Reserve Bank, the Court could give relief to the aggrieved party notwithstanding Section 21A to the extent of interest charged in excess of the rate prescribed by the Reserve Bank of India. A distinction was drawn between Court's power to interfere on the premise that the interest charged is excessive under the general law and courts G interference on the premise that the interest charged is in contravention of the circulars/directions issued by the Reserve Bank of India. In the former case it would not be permissible in view of the bar enacted by Section 21A of the Banking Regulations Act while in the latter case it would be permissible because of the Reserve Bank's circulars and directions having statutory force H under Sections 21/35A of the Act having been violated. The question whether

interest charged in excess of the minimum rate of interest appointed by the Reserve Bank without fixing a ceiling and levying higher rate to be charged at the discretion of each bank can be treated as excessive and unconscionable and whether in such situation Section 21A would debar the Court from reducing the rate of interest to a reasonable limit was left open and undecided as the same did not arise in the case before the Court. However it was made very clear that if the Reserve Bank has fixed the maximum rate of interest under Sections 21/35A of the Act any transaction charging interest within the limit so appointed would not be treated as excessive.

It is interesting to note that the same Bench which decided *D.S. Gowda's* case also decided *State Bank of India, Bhubaneswar* v. *Ganjam District Tractor Owners Association and Ors.*, [1994] 5 SCC 238, and held that where the agreement between the bank and the borrower did not provided for payment of compound interest or interest with periodical rests, the bank could not have charged the same.

During the course of hearing it was brought to our notice that in view of several Usury Laws and Debt Relief Laws in force in several States private money lending has almost come to an end and needy borrowers by and large depend on banking institutions for financial facilities. Several unhealthy practices having slowly penetrated into prevalence were pointed out. Banking is an organised institution and most of the banks press into service long running documents wherein the borrowers fill in the blanks, at times without caring to read what has been provided therein, and bind themselves by the stipulations articulated by best of legal brains. Borrowers other than those belonging to corporate sector, find themselves having unwittingly fallen into a trap and rendered themselves liable and obliged to pay interest the quantum whereof may at the end prove to be ruinous. At times the interest charged and capitalised is manifold than the amount actually advanced. Rule of *damdupat* does not apply. Penal interest, service charges and other over-heads are debited in the account of the borrower and capitalised of which debits the borrower may not even be aware. If the practice of charging interest on quarterly rests is upheld and given a judicial recognition, unscrupulous banks may resort to charging interest even on monthly rests and capitalising the same. Statements of Accounts supplied by banks to borrowers many a times do not contain particulars or details of debit entries and when written in hand are worse than medical prescriptions putting to test the eyes and wits of the borrowers. Instances of

A unscrupulous, unfair and unhealthy dealings can be multiplied though they cannot be generalised. Suffice it to observe that such issues shall have to be left open to be adjudicated upon in appropriate cases as and when actually arising for decision and we cannot venture into laying down law on such issues as do not arise for determination before us. However, we propose to place on
B record a few incidental observations, without which, we feel, our answer will not be complete and that we do as under :

(1) Though interest can be capitalised on the analogy that the interest falling due on the accrued date and remaining unpaid, partakes the character of amount advanced on that date, yet penal interest, which is charged by way of penalty
C 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.

(2) Novation, that is, debtor entering into a fresh agreement with creditor
D undertaking payment of previously borrowed principal amount coupled with interest by treating the sum total as principal, any contract express or implied and an express acknowledgement of accounts, are best evidence of capitalisation. Acquiescence in the method of accounting adopted by the creditor and brought to the knowledge of the debtor may also enable interest being con-
E verted into principal. A mere failure to protest is not acquiescence.

(3) The prevalence of banking practice legitimatises stipulations as to interest on periodical rests and their capitalisation being incorporated in contracts. Such stipulations incorporated in contracts voluntarily entered into and binding on the parties shall govern the substantive rights and obligations of the parties as
F to recovery and payment of interest.

(4) Capitalisation method is founded on the principle that the borrower failed to make payment though he could have made and thereby rendered himself a defaulter. To hold an amount debited to the account of the borrower capitalised
G it should appear that the borrower had an opportunity of making the payment on the date of entry or within a reasonable time or period of grace from the date of debit entry or the amount falling due and thereby avoiding capitalisation. Any debit entry in the account of the borrower and claimed to have been capitalised so as to form an amalgam of the principal sum may be excluded
H on being shown to the satisfaction of the Court that such debit entry was not

brought to the notice of the borrower and/or he did not have the opportunity of making payment before capitalisation and thereby excluding its capitalisation. A

(5) The power conferred by Sections 21 and 35A of the Banking Regulations Act, 1935 is coupled with duty to Act. Reserve Bank of India is prime banking institution of the country entrusted with a supervisory role over banking and conferred with the authority of issuing binding directions, having statutory force, in the interest of public in general and preventing banking affairs from deterioration and prejudice as also to secure the proper management of any banking company generally. Reserve Bank of India is one of the watchdogs of finance and economy of the nation. It is, and it ought to be, aware of all relevant factors, including credit conditions as prevailing, which would invite its policy decisions. RBI has been issuing directions/circulars from time to time which, *inter alia*, deal with rate of interest which can be charged and the periods at the end of which rests can be struck down, interest calculated thereon and charged and capitalised. It should continue to issue such directives. Its circulars shall bind those who fall within the net of such directives. For such transaction which are not squarely governed by such circulars, the RBI directives may be treated as standards for the purpose of deciding whether the interest charged is excessive, usurious or opposed to public policy. B C D E

(6) Agricultural borrowings are to be treated on a pedestal different from others. Charging and capitalisation of interest on agricultural loans cannot be permitted in India except on annual or six monthly rests depending on the rotation of crops in the area to which the agriculturist borrowers belong. F

(7) Any interest charged and/or capitalised in voilation of RBI directives, as to rate of interest, or as to periods at which rests can be arrived at, shall be disallowed and/or excluded from capital sum and be treated only as interest and dealt with accordingly.

(8) Award of interest *pendente lite* and post-decree is discretionary with the Court as it is essentially governed by Section 34 of the CPC *de hors* the contract between the parties. In a given case if the Court finds that in the principal sum adjudged on the date of the suit the component of interest is disproportionate with the component of the principal sum actually advanced the Court may exercise its discretion in awarding interest *pendente lite* and post-decree inter- G H

A est at a lower rate or may even decline awarding such interest. The discretion shall be exercised fairly, judiciously and for reasons and not in an arbitrary or fanciful manner.

In view of the law having been settled with this judgment, it is expected B henceforth from the banks, bound by the directives of the Reserve Bank of India, to make an averment in the plaint that interest/compound interest has been charged at such rates, and capitalised at such periodical rests, as are permitted by, and do not run counter to, the directives of the Reserve Bank of India. A statement of account shall be filed in Court showing details and giving particulars of debit entries, and if debit entry relates to interest then setting out C also the rate of, and the period for which, the interest has been charged. On the Court being *prima facie* satisfied, if a dispute is raised in that regard, of the permissibility of debits, the onus would be on the borrower to show why the amount of debit balance appearing at the foot of the account and claimed as principal sum cannot be so accepted and adjudged. This practice would D narrow down the scope of controversy in suits filed by banking institutions and enable an expeditious disposal of the suits, the issues wherein are by and large capable of being determined by documentary evidence. RBI directives have not only statutory flavour, any contravention thereof or any default in compliance therewith is punishable under sub-section (4) of Section 46 of Banking Regu- E lations Act, 1949. The Court can act on assumption that transactions or dealings have taken place and accounts maintained by banks in conformity with RBI directives.

We have dealt with the law governing the debtor and creditor relation- F ship. We have not dealt with any provision or principle of taxation law whereunder deemed payment of interest consequent upon capitalisation and actual payment whenever made may be treated as capital or revenue which question shall have to be determined under the scheme of relevant statutory enactment.

G Subject to the above we answer the reference in following terms :

(1) Subject to a binding stipulation contained in a voluntary contract between the parties and/or an established practice or usage interest on loans and advances may be charged on periodical rests and also capitalised on remaining H unpaid. The principal sum actually advanced coupled with the interest on

periodical rests so capitalised is capable of being adjudged as principal sum on the date of the suit. A

(2) The principal sum so adjudged is 'such principal sum' within the meaning of Section 34 of the Code of Civil Procedure Code, 1908 on which interest *pendente lite* and future interest i.e. post-decree interest, at such rate and for such period which the Court may deem fit, may be awarded by the Court. B

(3) *Corporation Bank* v. *H.S. Gowda and Anr.*, [1994] 5 SCC 213 and *Bank of Baroda* v. *Jagannath Pigment & Chem.* have been correctly decided.

All the learned counsel for the parties did their best to assist the Court in arriving at a just decision on the issues of significance and far reaching implications. However, we would like to place on record our appreciation of valuable assistance given to Court by Shri Ranjit Kumar, Sr. Advocate assisted by Shri K.M.K. Nair and Shri A. Subba Rao, Advocates, who appeared as *amicus curiae* on Court's request and with objectivity placed before the Court relevant material, judicial view-points and several authorities. As most of the borrowers were unrepresented, the Court needed their assistance. C D

Let all these appeals and SLPs be now placed before appropriate Bench for decision.

V.S.S. Appeals disposed of.