

(1977) 06 MAD CK 0007
In the Madras High Court

Canara Bank

APPELLANT

Vs

Indian Bank and Another

RESPONDENT

Date of Decision : 15-06-1977

Acts Referred:

Companies Act, 1956 — Section 125

Citation : (1978) 91 LW 57 : (1978) 1 MLJ 346

Hon'ble Judges : Ramaprasada Rao, J

Bench : Single Bench

Judgement

Ramaprasada Rao, J.—The controversy in this appeal is due to conflicting claims made by the Indian Bank, Madras and the Canara Bank,

Madras, both of which are as on date nationalised banks. Manasuba and Co., (P.) Ltd., (in liquidation), was admittedly functioning under the

managing directorship of one C.V. Raman who, as is not disputed before us, was the ace-mover of this company and the author of the various

transactions in which this company was involved. It is common ground that on representations which ultimately turned out to be false and

fraudulent, the managing director, C.V. Raman who was dealt with under the criminal law borrowed almost simultaneously on the hypothecation or

pledge of the same goods in the same godown from both the banks as above. The modus operandi by which the managing director was acting was

noticed by this Court in an earlier case reported in Official Liquidator v. Commissioner of Police ILR (1969) Mad.559, and it is unnecessary to

recapitulate the misconduct of the said managing director in the matter of borrowing on behalf of the company and on representations which were

ultimately found to be false and false to his knowledge. In fact, he has forged the signatures of the other directors while attempting to borrow from

the Banking institutions. The same methodology was adopted by him when he attempted to borrow from the two banks as above on the

hypothecation of stocks of timber stored at the open godowns at No. 84, Sydenhams Road, Madras-7 and at block No. 7, Edward Textiles, No.

2, De Mellos Road, Madras-7. On 30th November, 1959, the Company in liquidation through its managing director C.V. Raman borrowed

moneys on open cash credit account with the Indian Bank, and as collateral security for the re-payment of the amount that might fall due under the

said account, the company through C.V. Raman executed an agreement of that date. Clauses 1 and 4 of the said agreement are relevant for our

purpose and they are extracted hereunder;

Clause 1: That the goods, produce and merchandise mentioned in schedule hereto which have been already deposited and the goods produce and

merchandise which shall be hereafter deposited with the bank under this agreement shall be placed in the bank's possession and control, such

possession to be apparent and indisputable, and the same respectively are and shall be hereby pledged, and shall stand pledged and shall be

deemed to always stand pledged to the Bank as security for the payment to the Bank of the balance of the said cash credit account on demand by

the bank at any time.

Clause 4: That a register of the goods, produce and merchandise pledged as such security as aforesaid shall be kept by the borrowers and be at all

times open to the inspection of the bank, in which shall be entered particulars of all goods, produce and merchandise pledged to the Bank under

this agreement and all the goods and merchandise released and withdrawn. The borrowers shall furnish to the bank daily or at such intervals as the

Bank may require a schedule or copy, of all the entries which shall have been made in the said register on the previous day or a daily statement of

the stock which stands pledged to the bank and as contained in the said register at the close of the previous day and duly certified under the

signature of the borrowers. The statement of stock held by the borrowers, as agents for the bank returned from time to time is in the nature of

rendering of account by agent to principal and the statements so submitted shall be returns of the borrowers in their capacity as agents for holding

the goods pledged to the bank.

2. Under Clause (1), it is seen that the goods produce and merchandise mentioned in the schedule to the agreement which include all such stocks in the godown already deposited and the goods produce and merchandise which shall be hereafter deposited with the bank under the agreement

were placed in the bank's possession and control under the terms of the agreement as above; such possession with the bank was admitted to be

indisputable and apparent possession as well. The further, covenant was that the said stock in trade, merchandise, etc., shall stand pledged to the

Bank as security for the payment of the balance under the cash-credit account on demand by the Bank at any time. Having thus agreed and as a

consequence of such pledge, the Indian Bank secured indisputable possession of the stock and goods then existing and thereafter to be added in

the godown as above. A further covenant was contemplated and the parties agreed to the same as is seen from Clause 4 already extracted above.

Besides the obligation on the part of the borrower company to maintain a register of the goods in the godowns as above and besides entering the

day-to-day commercial transactions indulged by it with reference to such goods, the borrower shall furnish to the Bank daily a schedule or copy of

all the entries in the said register as above notifying to the Bank the nature of the transactions and dealings it had with reference to the goods

pledged with the Bank. The last sentence in Clause 4 is rather important, and is therefore, repeated by us-

The statement of stock held by the borrowers as agents for the bank returned from time to time is in the nature of rendering of account by agent to

principal, and the statements so submitted shall be returns of the borrowers in their capacity as agents for holding the goods pledged to the bank.

3. This express stipulation between the parties makes it clear that the Bank reiterated their right to hold the goods in their own right and that they

allowed the borrower, namely, the company in liquidation, to deal with such pledged goods which were in their juridical possession, under certain

circumstances and subject to certain regulations. This is the nature of the transaction which is entered into by the Company with the first respondent

on 30th November, 1959. As it is a pledge and as it related to a property of the company, the company had to register the said stock with the

Registrar of Companies u/s 125 of the Companies Act. The appellant herein which is the Canara Bank whose predecessor was the Pandyan Bank

also claimed that subsequent to 30th November, 1959 a similar arrangement was sought for with the Bank and that it was granted excepting for the fact that the appellant bank is not able to say that there was an agreement similar to the agreement entered into between the Company in liquidation and the first respondent bank wherein the possession of the goods was given to the lending bank and that the lending bank in turn authorised the borrower to deal with the pledged goods or hypothecated goods in accordance with the understanding or arrangement between them. But, what is however agreed is that this hypothecation which is far subsequent to the pledge in favour of the Indian Bank on 30th November, 1959 was also registered as a charge by the very company with the Registrar of Companies. The Company was later wound up under orders of Court in C.P. No. 21 of 1961. It is unnecessary to deal with the circumstances under which the winding up was made. Suffice it, however, to say that the main reason for such winding was based on various acts of omissions and commissions on the part of the managing director of the company in liquidation.

4. In the above conspectus of events, the appellant bank claimed an equal right with the Indian Bank, namely, the first respondent, on the foot that the dealings between the company in liquidation and the two Banks as above are similar in nature and that merely on the basis of the only "fact that the hypothecation or the pledge in favour of the first respondent bank was in point of time anterior to that created in favour of the appellant bank, priority cannot be claimed by the respondent bank. The contention was that the floating charges created in favour of the rival banks crystallised only on the date of the order of winding up, and that therefore, there can be no question of any priority as between the rival banks. The other contention was that as the transactions sprang from an open violation of moral laws and as the managing director forged the signatures of the other directors so as to gain such accommodation from the two banks, a technical accent upon the matter as if the first respondent ought to be preferred as a secured creditor in preference to the appellant bank on the only ground that the charge in favour of the first respondent bank was prior in point of time is not equitable, and such equitable adjustment as between creditors similarly placed under similar circumstances was envisaged by this

Court in the case reported in *Official Liquidator v. Commissioner of Police* ILR (1989) Mad. 559, and as that principle was also accepted by the

first Court in *The Punjab National Bank v. The Agent, Pandyan Bank, Ltd., Madras, etc.* O.S.A. Nos. 9, 22 and 83 to 85 of 1969, the counsel

for the appellant says that the learned Judge ought not to have said that the first respondent will have priority and first charge over the goods

pledged by the company with the appellant. We may incidentally conclude this part of the case by saying that after the winding up order, the

Official Liquidator was directed to sell the available stock in the godowns in which they were stocked and the stock has been now converted into

cash and as per directions of this Court, the Official Liquidator has invested the sum of Rs. 63,681 which was the available net sale proceeds.

5. The short question before us is whether the first respondent bank is to be preferred on the basis of the arrangement referred to by us in the

beginning or whether the two banks should share the sale proceeds *pari passu*.

6. It is unnecessary for us to deal at length with the principle which has to be invoked in the instant case as one of us laid down the principle that in

such circumstances there should be a fair and equitable distribution of the assets of the company in liquidation as between the creditors similarly

placed, and as that principle has been approved by a Division Bench in *O.S.A. No. 9 of 1969, etc., batch*, we rest content by stating the

observations of the Bench:

The transactions entered into with the Pandyan Bank and the other Banks were all by the managing director, but the Judge has found that he has

forged signatures of the other directors figuring as guarantors. It is no doubt true that the Pandyan Bank in point of time was the first lender in the

case of these vehicles so far as these appeals are concerned. But it does not follow from it that in the liquidation proceedings that fact alone should

weigh with the Court. Considering that the documents on the basis of which loans were raised were defective inasmuch as they were partly forged

and that the banks were defrauded the learned Judge was right in departing from the normal rule that priority in mortgages must settle the priority of

payment. We think that the learned Judge was justified in the circumstances in taking the view that equity demands that the banks should be equally

treated and that they should each be paid *pari passu* in proportion to the

amounts due to each of them or the vehicles in question on the date of the liquidation of the company.

7. The learned Judges of the Division Bench agreed with the principle that the normal rule of priority as applicable to mortgages and pledges should not be invoked in the instant case having regard to the fact that institutions have been compelled to part with funds on false representations and this element ought to weigh while considering the equities as between the parties. No doubt that was a case where the managing director of the company in liquidation obtained advances from the banks and other creditors in respect of certain motor vehicles and it related to hire-purchase agreements and hypothecation agreements. This particular aspect alone weighed with the learned Judge when he said in the order appealed against-

But, in the case now before me, I am concerned with pledges of goods, produce and merchandise, and as such the aforesaid observations cannot be applied, and an order passed directing payment to be made to the applicant bank and the first respondent bank *pari passu* in proportion to the amounts due to each of them.

8. With great respect, we are unable to agree with the learned Judge that motor vehicles are also goods in the eye of law as much as produce and merchandise are. The important thing to be noticed in the instant case is whether the methodology adopted by the managing director of the company in liquidation was similar in the case cited before us and in the case to be adjudicated upon by us. We do not find any reasonable difference between the two at all. In one case the subject-matter of the pledge was motor vehicles and the hire purchases related to them, and in the instant case the pledge of the hypothecation relates to goods, produce and merchandise. Even apart from this, the Bench, in the circumstances of this case, had to point out that equity demands that the Banks should be equally treated. The same goods were pledged by the same managing director under similar documents with banking institutions. This was noticed by the learned judge and was not even disputed before us. Therefore, the company in liquidation channelised their attempts illegally, and by a process which normal and reasonable persons cannot comprehend. It was in those circumstances, in the earlier case, a special favour in favour of the

Banks which have admittedly suffered a wrongful loss was shown and their rights were adjusted so that they could gain a division of the available assets equally.

9. In the light of our conclusion as above, it is unnecessary for us to go into the other question whether a valid pledge has been created in favour of

the first respondent bank and whether the weight of the pledge or the hypothecation created in favour of the appellant bank is in any way lighter or

different from the pledge in favour of the first respondent bank. We have already expressed the view that the judicial possession of the goods

vested with the first respondent bank in view of the agreement dated 30th November, 1959. It is easy to presume in this case that as the pattern

adopted by the managing director to obtain the advances from the banks is the same, he could have obtained such loans on the hypothecation of

the same goods under similar terms even with the then Pandyan Bank and now the Canara Bank. We were at pains to find out from the summary

of the facts rendered by the learned Judge whether there was any different method adopted by the managing director of the company in liquidation

when he secured the loan from the Canara Bank, but we did not find any. We are therefore, constrained to presume in the instant case that all

transactions made by the managing director which resulted in the pledge of the stock with two independent banking institutions were under similar

terms and subject to the same conditions. There is no serious dispute on this aspect before us.

10. Having regard to the fact that the managing director obtained such advances and credits by means which are not regular and which are no

doubt fraudulent as well, we apply the principle adopted by the Division Bench in O.S.A. No. 9 of 1969 batch already referred to, and direct the

Official Liquidator to divide the sale proceeds *pari passu* between the two banks, namely, the appellant bank and the first respondent bank, in

proportion to the amount due to each of them. We make it however clear that in view of the later decision of our Court in Commissioner of

Income Tax, Madras v. Manasuba and Co. (P.) Ltd., An liquidation, by Official Liquidator ILR (1969) Mad.559, that the income from such

investment made by the Official Liquidator belongs to the company, and is not available to the two creditors as above, this *pari passu* division

would only refer to the principal amount of Rs. 63,681, but, the division shall be in proportion to the amount due on the date of liquidation of the company. The appeal is allowed to this extent. There will be no order as to costs.