

(1944) 01 MAD CK 0039
In the Madras High Court

Fazal Ellahi

APPELLANT

Vs

Ram Mohan and Co.

RESPONDENT

Date of Decision : 25-01-1944

Acts Referred:

Presidency Towns Insolvency Act, 1909 — Section 52

Citation : AIR 1944 Mad 403

Hon'ble Judges : Somayya, J

Bench : Division Bench

Judgement

Somayya, J.—The suit is for recovery of a sum of money being the balance of purchase money due in respect of goods sold by the plaintiff to defendant 1 firm. Defendant 1 firm executed a deed of trust for the benefit of its creditors constituting defendants 2 and 3, as the trustees. Defendant 1 is ex parte. Defendants 2 and 3 do not dispute the amount claimed but deny the plaintiff's claim to recover the suit amount by way of a first charge over the assets in their hands. The plaintiff claims a first charge under these circumstances. The contract under which the goods (hides and skins) were sold to defendant 1 is not disputed. The plaintiff who is a merchant carrying on business at Calcutta despatched goods by train. The railway receipts were sent to the National Bank of India, Calcutta with instructions to hand them over to defendant 1 at Madras through the local branch of the National Bank of India on defendant 1 accepting a bill of exchange drawn by the plaintiff on defendant 1 for the price, freight, etc., payable at sixty days after sight, and on defendant 1 further executing what is called a trust receipt. Several sales were effected by the plaintiff on this basis and we are now concerned with the sale which was effected on 6th December 1941. The price was Rs. 8951-9-0 and in respect of the price, freight, etc., a bill of exchange was drawn on defendant 1 for the said sum. The bill of exchange was accepted by defendant 1 and handed over to the Madras branch of the National Bank of India along with a trust receipt executed by defendant 1 in favour of the National Bank. The railway receipts and the other documents in respect of this consignment were handed over to defendant 1. The bill of

exchange was not honoured on the due date. Later on some payments were made and the suit is for the balance due. The plaintiff claims that the National Bank of India was only an agent for collection and that they are entitled to the benefit of the trust receipt. It is alleged that under the trust receipt, the plaintiffs are entitled to a first charge over the goods so long as they are unsold by defendant 1 and after their sale by defendant 1 on the sale proceeds thereof. Defendants 2 and 3 who are the trustees for the creditors of defendant 1 have no objection to the plaintiffs claiming rateably with the other creditors as unsecured creditors, but they deny the claim of the plaintiff to a first charge over the assets in their hands. The assets consist of certain goods and some sums of money of which they obtained possession. As regards the trust receipt, these defendants set up that it is invalid for the various reasons which will be adverted to later. Thus the only issue which falls to be decided is whether the plaintiff is entitled to a first charge over the assets of defendant 1 in the hands of defendants 2 and 3. Ex. P-1 is the trust receipt executed by defendant 1 in favour of the National Bank. It was faintly urged that the plaintiff is not entitled to sue upon it, but the plaintiff's allegation is that the National Bank of India took the documents in question for the plaintiff's benefit and this is supported by the documentary evidence in the case. It does not really matter so far as defendants 2 and 3 are concerned whether the plaintiff is entitled to a charge or the National Bank of India. The main question which was fought out during the arguments was whether the trust receipt is invalid and ineffective to create a charge.

2. No oral evidence was adduced on either side and the question has to be decided on the documents. Ex. P-1 is the trust receipt executed by defendant 1 before taking delivery of the consignment in question and Ex. P-2 is the bill of exchange for Rs. 8951-9-0 being the value of the goods sold together with the incidental charges. The bill of exchange was accepted by defendant 1. The material portion of the trust receipt which is addressed to the manager of the National Bank of India, Limited, Madras, is as follows:

In consideration of your handing over to us the shipping documents of the goods us per particulars at the foot of this receipt held by your bank, as security for payment of the bill drawn by S. Fazal Ellalii on us dated 16th December 1941 for lis. 8951-9-0 (Ex. P-2) being the invoice value of the said goods payable to your bank, we hereby undertake to land, store and hold the said goods until sale, and to sell the said goods as the Agents and Trustees of your bank and that until sale the said goods and after sale the proceeds thereof shall be held as and shall remain the property of your bank We undertake that the proceeds of the said goods shall in all things be treated by us in our books as belonging to your bank and ear-marked as the bank's property until the above-mentioned acceptance shall be fully paid and satisfied by us.

2. We further undertake that all sales by us of the said goods shall be either for cash to be received and paid over to you ... us above provided for ... and we also undertake at any time to hand over to you on demand all goods covered by this

trust receipt for the time being unsold and authorise you or any one authorised by you in writing in that behalf to enter our godowns and take possession of the said goods at any time.

* * * * "

4. We also undertake at all times to keep the goods covered by this trust receipt insured against fire to their full value and to hand over to you on receipt all moneys received from the insurers under the policy or policies effected by us such policy or policies being in the meantime held by us as trustees for your bank and to be transferred to you at any time on demand.

5. We acknowledge and declare that the goods covered by this trust receipt and the monies from time to time outstanding in respect thereof represent a separate transaction distinct from all goods held under similar trust receipts or monies outstanding in respect thereof and that the aggregate of such goods and monies shall not be deemed or taken to constitute a general credit from your bank to us.

6. On the payment by us of the full amount of the above acceptance this trust receipt shall be delivered tip to us cancelled and thereupon any goods covered thereby which may be unsold or any proceeds thereof which shall be outstanding or unrealised shall be our absolute property." The effect of such trust receipts has come up before the Courts very often in bankruptcy proceedings where goods are held under such trust receipts or delivered over under such receipts and the person to whom the goods are so delivered is adjudged a bankrupt; it has been invariably held that the Official Assignee is entitled to take possession of the goods and to administer them for the benefit of all the creditors under the order and disposition clause enacted in Section 52, Presidency Towns Insolvency Act. As against the assignee in bankruptcy the seller cannot assert his rights. The true position governing such cases was discussed by Ameer Ali J. in *In Re: Sumermull Surana*, and in a case arising in the Insolvency Side of this Court in Appln. No. 1 of 1940 (I. P. No. 142 of 1939), this Court adopted the view laid down by Ameer Ali J. in the above case. The trust receipt which came up for consideration in the Calcutta case is set out in pp. 819 and 820 and is very similar to the one which I have to consider. The only difference is that in that case the trust receipts were executed in favour of the sellers direct and in this case they were executed in favour of the National Bank of India, but it is clear that in taking the trust receipts in their name the National Bank of India were acting for and on behalf of the plaintiff. On p. 821 the learned Judge says this:

The exigencies of trade apparently require that buyers should be given possession and control of goods for the purpose of sale before payment. This has led to the adoption by the sellers of various devices designed to maintain some connexion with or control over the goods; some invisible machinery by which the sellers can prevent goods being dealt with or passing from their buyer to the seller's detriment. Two kinds of situations arise, one as between sellers and buyer simply, and the other as between sellers, bank and buyer.

In the present case the question is as between the sellers and the buyer, the bank being only the nominee of the seller. The learned Judge proceeds to state this:

The situation to be considered here is between buyer and seller simply, but, in my opinion, the same principles apply to the situation as between bank and buyer. As between the seller and buyer, the seller has three classes of difficulties to face -(1) vis-a-vis the buyer, (2) vis-a-vis the transferees, or (3) vis-a-vis the Official Assignee

(1) As against the buyer, whether the property passes or not, whether or not the seller has lost his lien, he yet has, whatever form of document he takes from the buyer, a valid contract and the buyer is bound by that contract and in proper proceedings the seller can enforce his rights, possibly by injunction, possibly by receiver, but, in any event, he has a remedy. The real difficulty is against third parties and the Official Assignee" After referring to the various devices to which the sellers of goods resort in order to prevent the property in the goods sold vesting in the Official Assignee in cases of bankruptcy, the learned Judge points out that "delivery plus a document or device purporting to create fiduciary ownership on the part of the buyer, i. e., trust" is one of the devices resorted to. After dealing with the other cases of devices, the Judge deals with the device of trust on page 823 thus: "There remains the question of trust. As already indicated I propose to assume that the clause here (cl. 34) is equivalent to a trust receipt. Now, it is clear that trust receipt may be considered something more than mere contract: see *In Re David Allester Ltd.* (1922) 2 Ch. 211. Sellers resorted to the device of trust for the reason that, as a general rule, trust property does not vest in the Official Assignee and is excluded from the scope of reputed ownership. That general rule is based upon the theory of law that the trustee is the owner. Therefore, there is no other owner who can give his consent to reputed ownership, by the buyer." He winds up the discussion by pointing out on page 826 thus:

Secondly, trust receipts taken by a trader seller from a trader buyer so far as they purport to create an agency for sale do not preserve the property from reputed ownership unless the relationship of the parties is known to the public. The commonsense of the matter is this, that no special words or, legal formula can preserve a control where actual control has been abandoned nor maintain a connexion with the goods when the connexion has been in fact severed or save for the seller, property which a seller hands over to a buyer, with capacity to deal with it either as against the transferees for value or against the Official Assignee. If the exigencies of trade require that the goods must be handed over for sale the seller takes the risk, he cannot put that risk upon the public which deals with his buyer ostensibly in possession of those goods as owner." From this discussion it is clear that except as against the assignee in bankruptcy or against transferees for value the contract is valid as between the buyer and seller and the buyer cannot repudiate the contract as an illegal one. Defendants 2 and 3

cannot claim a higher position for themselves though they are trustees for the general body of the creditors. There being no adjudication, the doctrine of reputed ownership does not come in and there is no reason to hold that defendants 2 and 3 are not bound by the terms of Ex. P-1. The argument of Mr. Srinivasachari, the learned advocate for defendants 2 and 3. is that, if permitted, such a contract would defeat the provisions of the Bankruptcy law which provides for equal distribution of a debtor's goods among all the creditors. Section 23, Contract Act, is relied upon by Mr. Srinivasachari and the material portion relevant to the point under discussion runs thus : " The consideration or object of an agreement is lawful unless it is of such a nature that, if permitted, it would defeat the provisions of any law, or is fraudulent." In *In Re: Nripendra Kumar Bose*, , the question arose in the Insolvency Court after adjudication of the buyer. The actual question for decision was whether the property in the goods vested in the Official Assignee after bankruptcy. The learned Judge referred to Section 52 (1) (a) and to, Section 52(2)(c), Presidency Towns Insolvency Act, and stated thus on page 1078 : "If, therefore, the property in the goods never passed to Bose, in my opinion, it is clear upon the facts that the goods were in his reputed ownership within the meaning of Section 52 (2) (c). On sale of goods, the property in the goods passes, when the parties intend that it shall pass, as shown by the terms of the contract, and the circumstances of the case. Where the delivery of the goods or of a document giving control of the goods is to be in exchange for payment of, or security for the price of the goods, the seller, unless a contrary intention appears, reserves the right of disposal and the property in the goods, until payment, or security, be made or given accordingly. In the absence, therefore, of the trust receipt, the property in these goods would have passed to Bose on signing the pronote and not before. But the effect of the trust receipt was to postpone the transfer of property until payment. Apart, however, from these considerations, the arrangement made by the petitioners was only an ingenious attempt to defeat the provisions of the Insolvency Act. While putting it in the power of Bose to obtain credit on the strength of the goods with which they supplied him, they tried nevertheless to secure a preference for themselves over all other creditors. Even if they had succeeded in drafting a document, which would have been sufficient to create a trust, in my opinion, such a trust would not have been legal or valid. A trust must be created in good faith.

The same Judge (Lort-Williams J.) in *Chartered Bank of India Vs. Imperial Bank of India*, , agreed with the view expressed by Ameer Ali J. in *In Re: Sumermull Surana*, and re-stated his view thus on page 273:

So far as the present case is concerned the question can be disposed of shortly: Whatever be the relation created as between the plaintiffs and Kerr Tarruck and Co., whether the trust receipts created contracts of agency or something more, such as a trust, they cannot affect the defendants, who had no knowledge of them and who, bona fide, had given valuable consideration for the goods pledged ... It seems to me clear that Kerr Tarruck and Co., were in possession of the goods within the meaning of the old Section 178, Contract Act, and could and

did make a valid pledge of them to the defendants apart from any question arising under the terms of proviso 2." The above case was as between the seller of goods and a person who advanced money to the buyer on a pledge of those goods. Kerr Tarruck and Co., were the buyers and they obtained the goods on executing trust receipts in favour of the plaintiff-bank. They later on pledged them with the defendant-bank who received the goods in good faith as belonging to the importers without any knowledge of the trust receipts and allowed overdraft on the security of the pledged goods. The question was whether the plaintiff's claim prevailed over the right of the defendants as pledgees of the goods. It was sufficient for the learned Judge to dispose of the case to rely, as he did, on Section 178, Contract Act, and indeed this is the second case formulated by Ameer Ali J. in *In Re: Sumermull Surana*, . After pointing out that Section 178, Contract Act, enabled the importers Kerr Tarruck & Co. to make a valid pledge to the defendants, Lord-Williams J. went on to say that no trust was or could be made by means of the trust receipt. He stated his view thus:

The real object of such documents as trust receipts, in this as in many other cases, seems to be, to try and defeat the provisions of Section 52 (2) (c), Presidency Towns Insolvency Act, and this Mr. Warwick was finally constrained to admit was the real object of the plaintiffs in issuing them. ... In any case, such would be the effect if permitted. This would offend against the provisions of Section 4, Trusts Act, as also would the involved breach of contract between the Chartered Bank and the shippers." Mr. Srinivasachari, the learned advocate for defendants 2 and 3, urges that the view propounded by Lord-Williams J. in the two cases is to be accepted. But in both the cases the real ground of decision was not that the contract was illegal. In the first case bankruptcy had supervened and the question was against the assignee in bankruptcy. The learned Judge held that u/s 52, Clause (2) (c), (Order and disposition clause) of the Presidency Towns Insolvency Act, the goods vested in the Official Assignee. In the latter case the defendants were bona fide pledgees who advanced moneys without notice of the trust receipts and Section 178, Contract Act, was invoked. From the mere fact that a fraudulent preference was intended in favour of certain persons, it does not follow that a contract or disposition of property is not valid as between the parties to the contract. As has been pointed out by the Judicial Committee in *Minakumar v. Bhoj Singh* A.I.R 1916 P.C. 238, where a debtor transfers property to one creditor with a view to give a fraudulent preference to that creditor over others, there is nothing illegal though in the event of bankruptcy supervening, the transaction would be invalid as against the assignee in bankruptcy. There the object of the transaction is obviously one to defeat the provisions of bankruptcy law which requires equal distribution among all the creditors and yet though the object of the alienation is to defeat this equality of distribution, and though it would be avoided in the event of a bankruptcy, it is clear that as between the parties to the contract they are bound by it. I therefore hold that the mere fact that the object of the transaction is to prevent equality of distribution among the creditors, it is not a ground for holding that the contract

itself is illegal or that it is not binding upon the seller or upon voluntary transferees from him. No decision has been brought to my notice laying down that such a transaction is illegal as between the parties to the suit except the observations of Lord-Williams J. in the two cases above cited. If the transaction is binding on defendant 1, as I hold it is, there was no suggestion that it is not binding on defendants 2 and 3. The whole argument was directed to show that it was not binding against defendant 1.

3. The defendants urge that defendant 1 became the owner the moment that he accepted the bill of exchange, that the execution of the trust receipt amounts only to a pledge and that the pledge is invalid as the goods were in pledgor's possession. If this is the true position, there is the authority of the House of Lords in *N.W. Bank v. Poynter, Son and Macdonalds* 1895 A.C. 56, that the transaction is good as between the parties to the transaction. A pawnee may re-deliver the goods to the pawnor for a limited purpose without thereby losing his rights under the contract of pledge as for the purpose of enabling the pledgor to sell the goods on the pledgee's behalf : see also *Pollock and Mulla's Contract Act*, p. 544, Edn. 6. The plaintiff will have a decree as prayed for with costs against defendant 1 and against the assets of defendant 1 in the hands of defendants 2 and 3. Defendants 2 and 3 may take their costs out of defendant 1's estate in their hands.