

(1936) 02 BOM CK 0009
In the Bombay High Court
Case No : I.C. No. 33 of 1933

In Re: Fazalbai Mills Limited (In Liquidation)

Date of Decision : 07-02-1936

Acts Referred:

Trusts Act, 1882 — Section 3

Citation : AIR 1936 Bom 296 : (1936) 38 BOMLR 541

Hon'ble Judges : Kania, J

Bench : Single Bench

Judgement

Kania, J.—These proceedings arise from the report of the liquidator to settle the list of creditors. In the liquidation proceedings claimants 1 to 80, 189, 190 and 191 claim that, because they were members of the provident fund, founded by the company, they were preferential creditors and entitled to rank as such in the winding up of the company. All these persons were the employees of the company. In the claims filed by them fifty-nine claimed priority from the commencement, two claimed priority subsequently by giving notice, while twenty-two have not claimed priority in express terms. In my opinion justice requires that the rights of all the parties should, however, be determined irrespective of this consideration.

2. The first point which arises for consideration is, whether the company was a trustee in respect of the amount standing to the credit of the employees, who were members of the provident fund, or at any rate occupied a fiduciary relationship towards them. It is common ground that fiduciary relationship may be established without the use of the word "trust" and that a person may become a trustee by his acts and conduct so as to deprive himself of all beneficial ownership of a property and declare that he will hold the same in trust for another. Section 3 of the Indian Trusts Act defines "trust" as follows :-

Trust is an obligation annexed to the ownership of property arising out of confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of another or of another and the owner.

3. This definition clearly shows that because the owner retains a certain interest

in the property it would not necessarily go against the foundation of a trust. This question must be considered with reference to the provident fund rules of the company read as a whole. The rules were framed when the fund was started. After the fund was so started, a subsidiary ledger, as provided by Rule 10, was opened in which the amount standing to the credit of each member, consisting of his contribution and the company's contribution, with interest thereon, was credited every year. The amount if any advanced to the member was debited. The total balance of all accounts, entered in the subsidiary ledger, was entered under one item in the general ledger of the company and shown in the balance-sheet under the heading " Provident Fund Deposit". The subsidiary ledger is headed " Deposit Account" and in the company's general ledger also it is described as " the Provident Fund Deposit balance ". The fund was so founded in April, 1919, and the object of the fund, as stated in Rule 3, was to make provision for the employees and their family on the death of each member or on his leaving service.

4. In about July, 1932, the company came into difficulties, and some members having heard that the directors proposed to close the fund, a petition signed by some members was forwarded to the company. That petition is exhibit B. The signatories thereby informed the directors of the mills that having heard that the company was considering the question of discontinuing or closing the fund they had made the petition. They mentioned that the object of the fund was to make a provision for the members and their family available on the death of each member or on his leaving service and to secure interest at six per cent, to the members, and to carry out the objects of the fund they made the proposals contained in the petition. The first proposal was that the amount standing to the credit of each member on the date of the closing of the fund should be allowed to remain in deposit with the company as a deposit by such member carrying interest at six per cent, to be paid at the end of every year. Clauses 2 and 3 suggested that the deposit should continue till the member died or left service and the same should be paid to his heirs or him on the termination of service. This petition was submitted to the directors and considered by them at a meeting held on September 15, 1932. The minutes of that meeting show that the directors did not accept that petition and did not proceed on that footing at all. The directors on the other hand suggested to the agents to frame a scheme under which the provident fund, which was intended to be closed, should be paid off to the members. It appears that thereafter the agents thought out a scheme. [After setting out the resolution embodying the scheme, the judgment proceeded :]

5. After this resolution was so entered in the rough and fair minute books, the agents paid seven instalments and the receipts signed by some members are put in. There is also a specimen entry showing the payment of interest to some members. On September 4, 1933, the directors passed a resolution whereby instead of paying the balance to each of the members by thirty-four instalments, as provided in the first resolution, they resolved that the balance should be paid

by sixty instalments. It is common ground that this was not done at the suggestion or application of any member. The evidence further shows that even before the resolution was passed on September 4, 1933, payment at the reduced instalment was made to some members at the end of August, 1933.

6. The liquidator has considered the first contention of the members as to whether the fund was held by the company in a fiduciary relationship. The learned counsel for the liquidator contended that by reason of Rule 21 the company has the first and paramount charge upon the amount from time to time standing to the credit of each member. From that it was sought to be argued that the amount standing to the credit of the member was the member's property otherwise it would be meaningless to contend that the company had a charge on the same. In my opinion, that contention is not correct, because the fact that the company was to get a charge under certain circumstances on this amount is inconsistent with the position that the money belonged to the company, as it would, if it was an ordinary deposit by a depositor with the company. In the same way the provision contained in Rule 23 provided that in certain circumstances the contribution of the company shall be refunded to the company. That would be inconsistent with the relationship of debtor and creditor, which would be the position if the creditor had deposited money with the company in the ordinary course. In the same way the contention, that the directors were given absolute discretion for payment on retirement, in cases governed by Rule 16(6), and the provision in Clause (c) of Rule 16, go against the existence of fiduciary relationship, is not correct, because all the rules have to be read as a whole. I should point out in particular Rule 16(c), under which the lapsed amounts, which were not paid to members because of their gross misconduct or fraud or other reasons, mentioned in the preceding part of that rule, enured for the benefit of the other members. That clause in particular indicates that although the member forfeited his interest, because of certain events, the lapsed amounts did not belong to the company, but continued to remain as trust property for the benefit of the other members. The decision in *Re. Alliance Bank of Simla, Ltd.* 28 C. W. N. 721, mentioned by the liquidator in his report, was attempted to be distinguished on the ground that no words indicating that the fund was to revert to the company under certain contingencies, as found in the *Calcutta* decision, existed here. As I have pointed out Rule 23 contains the words " shall be refunded " to the company. That, in my opinion, is substantially the same as the meaning attached to the words " revert to the company" in the *Calcutta* decision.

7. It was next pointed out on behalf of the liquidator that the payment of interest and the fact that in the interval the fund was intended to be used by the company indicate that there was no fiduciary relationship but that the company stood in the position of a debtor only. In support of that contention reliance was placed on the decision in *In re Maneckji Petit Manufacturing Co.* (1931) 34 Bom. L.R. 728. The question in that case was about the deposit made by the selling agents of a mill as security for the due discharge of the terms of the agency

agreement. The company bound itself to pay interest on the amount deposited, and agreed to invest the amount in Government securities and keep the securities ear-marked to the satisfaction of the agents, if the company issued debentures or mortgaged its Immovable properties. The latter contingencies did not happen. The company then went into liquidation and in the liquidation proceedings the selling agents claimed that there was a fiduciary relationship between the parties in respect of the deposit and therefore claimed to rank as preferential creditors. The Court negatived the contention. In the course of his judgment B. J. Wadia J. observed that the fact that the company was entitled to use the money for its own purpose and pay interest in the meantime were incidents which tended to show that there was a deposit and there was no fiduciary relationship. It appears from the report that the attention of the learned Judge was not drawn to the decision in *Gee V. Liddell* (No. J) (1866) 35 Beav. 621. In that case there was a provision under which the trustee was permitted to retain the money in his own hands and pay interest at a specified rate to the beneficiary, the trustee presumably being entitled to make such use of the capital or interest as he thought fit. It was not suggested that the provision prevented the transaction from being a trust. Moreover the relationship between the parties in the present case stands altogether on a different footing. The object of the fund as stated expressly, was to provide an amount when the member either retiree from service or died. The company contributed its share equally with the member. The members were again all employees of the mills and every member drawing a salary of Rs. 250 or more per month was obliged to be a member of the fund. In *re Manekji Petit Manufacturing Co.* was an entirely different case where the selling agents had deposited money for the fulfilment of there own obligation under the selling agency agreement. There was no question of contribution by the company and no question of employment, as the term is ordinarily understood between master and servant. I think, therefore, that that decision does not help the liquidator. Having regard to the definition of " trust" in the Indian Trusts Act, I also do not see any reason why there cannot be a trust merely because the company expressly reserved the right to utilise the trust fund for its own purpose and agreed to pay interest in the meanwhile, to each member as provided in Rule 12. It was next urged on behalf of the liquidator that throughout the rules the fund is described as a deposit and, therefore, it was a deposit and not a trust. As I have pointed out, it is not necessary, to create fiduciary relations, to use the word " trust", and the Court has to look at the rules as a whole to arrive at the correct meaning thereof. The rules describe it a deposit, but it is a provident fund deposit, and therefore it will not be correct to read the word " deposit" detached from the words " provident fund ". The rules have also to be read along with the object for which the fund was made and founded. This argument was similarly rejected in the Calcutta decision mentioned above. In my opinion, therefore, on a true construction of the rules as a whole, fiduciary relationship between the company and the members of the fund is established and the provident fund deposit account is a trust account.

8. On that footing it will be on the liquidator to establish that the relationship between the parties was altered by an agreement, express or implied. The first step relied upon by the liquidator in this connection is that a petition was sent to the directors in which each signatory individually asked the directors to hold the amount standing to his credit as a deposit made by him with the company and on which the company was asked to pay interest at six per cent. It is, therefore, contended that the signing members themselves suggested an alteration of the relationship. In this connection it should be first noted that claimants Nos. 6, 17, 46, 57, 58, 60 and 63 have not signed the petition. The evidence further shows that the signatures of claimants Nos. 32, 3, 51, 70, 49, 23, 75, 18, 42, 67, 35, 30, 15, 40, 41, 33, 37, 44, 74, 14, 38, 29, 69, 31, 1 and 43 are not proved. It is important also to note at this stage that the signatures of these claimants on the alleged receipts of instalments or interest are equally not proved. Under the circumstances, in respect of these parties there being no other express agreement, no question of implied agreement by conduct arises. The contention of the liquidator that these claimants are not entitled to rank as preferential creditors must, therefore, fail.

9. As regards the claimants whose signatures are proved or admitted, it is necessary to remember that this petition was submitted to the directors, but was rejected. In my opinion, therefore, no effect could legitimately be given to the proposal which suggested that the amount standing to the credit of the signing members should be treated as a deposit by such members. I do not think it is permissible to the liquidator to contend that although the proposal was rejected in toto, he is entitled to rely on this expression of desire of the members in connection with the subsequent conduct of the members. The directors, having refused to entertain this petition, asked the agents to frame a scheme. The resolution which they ultimately passed on December 1, 1932, was as follows : [After setting out the resolution, the judgment went on :] The directors have themselves thus specified the manner in which this proposal, which was a fresh proposal put forward by them, should be accepted by the members, inasmuch as at the beginning of the resolution they expressly say, " Subject to the members of the fund signing their acceptance to the scheme ". It is common ground that after the resolution was passed no member had signed his acceptance to the scheme as provided in the resolution. The Indian Companies Act provides that the articles of association govern the relations of the parties and the board of directors and the agents. If, therefore, this proposal put forward by the directors expressly mentioned that the same, if accepted, should be accepted in a particular manner, I do not see how it will bind the company, in the event of a dispute arising between the parties, if the same was not accepted in that particular manner. In the case of individual contracting parties it may be contended that there was an implied agreement by conduct. In the present case I do not think it is open to the company to contend that although the acceptance was not signified as mentioned expressly in the resolution, the same should be considered as a complete agreement because it was alleged by them that it was

acted upon by the agents and by some members. On that footing, the contention of the liquidator, based on the resolution, must fail.

10. Even if there were any doubt as to the correctness of this view, the ultimate result is the same. The directors passed a resolution which contained the proposal that the amount standing to the credit of each member should be allowed to remain a deposit with the company by the member carrying interest at six per cent, and be paid off as specified therein. The evidence of conduct of both, the company and the members, stands thus : since the fund was started the company had maintained a subsidiary ledger, as I have indicated above. The same ledger continued to be maintained without any interruption and without indicating that any alteration in the relations of the parties had taken place. The statement in the balance-sheets continued to be in the same terms. It was admitted by the accountant called on behalf of the liquidator that when loans were given against the provident fund to members before 1932, receipts were taken, and in respect of the loans advanced subsequently, receipts in the same terms were similarly taken. It was further admitted that in respect of the deposits made with the company by individuals the company issued fixed deposit receipts. After the resolution was passed in December, 1932, admittedly no such receipts were issued to any member of the provident fund. This is the conduct of the company. As regards members, the only evidence led on behalf of the liquidator is of receipts passed by some members when seven instalments of principal, worked out on the footing that the provident fund was to be repaid in forty-three instalments, one of interest for the year ending July, 1933, and one altered instalment, were paid. The liquidator has not suggested, and the evidence, of Mr. Ahmed and the accountant called on behalf of the liquidator also do not suggest, that the terms of the resolution were conveyed to individual members, either before or after the instalments were so paid. The terms of the receipt passed by each member only mention that it was an instalment of the provident fund. There is no indication in the wording of this receipt to show that the members received those instalments with the knowledge of the terms of the resolution. Receipts in the same terms would be passed if the directors had intimated to the members that the fund had been closed, but because of financial difficulties the company would not pay the amount forthwith, as they were bound to pay on the closing of the fund, but the same would be paid in instalments, and in the meantime the company will pay interest to each member for the amount standing to his credit. It is important to bear in mind that in that event there would have been no alteration in the original relations between the parties. If so, what more has been established by the liquidator to show that there was an agreement to alter the relations ? To my mind, nothing at all. The suggestion of the agreement, so far as the company is concerned, is based only on their acts in paying the instalments as entered in their books. From that the company asks the Court to infer that they paid the instalments in pursuance of the resolution. That is the highest the point could be put and nothing further. The two necessary steps which must occur thereafter to complete the agreement, viz. that the

proposal, which in terms intimated that the legal relation between the parties was going to be altered was conveyed to the members, and that it was accepted by them after such knowledge, are wanting in this case. In my opinion, therefore, the liquidator has failed to establish that there was an alteration in the legal relation between the parties as it originally existed. In respect of the signing members also, therefore, there being no agreement to alter the relations, the original footing on which the provident fund existed must stand and the members are entitled to rank as preferential creditors.

11. The evidence of Kale, the Superintendent in the Court Liquidator's Office, shows that sufficient liquid assets were in existence on the date of liquidation, from which the fund could be paid in full with interest up to the date of liquidation. In the winding up of the company, rules prevailing in insolvency govern the rights of the parties according to Section 229 of the Indian Companies Act, and having regard to the decision in (1933) L.R. 60 I.A. 203 (Privy Council) no question of making a tracing order remains. The liquidator should, therefore, allow the claims of claimants Nos. 1 to 80, 189, 190 and 191 as preferential creditors, and in the certificate to be issued they should be shown as such. The costs of the claimants appearing before me on the footing of a long cause, except their costs of and in connection with the allegations of undue influence, coercion and threats of dismissal, be added to their respective claims and be paid by the official liquidator out of the assets of the company in his hands. The costs of the official liquidator, taxed between attorney and client, on a long cause scale, to come out of the assets of the company in his hands. Two counsel allowed to the official liquidator and claimants Nos. 28, 60, 63 and 79.