
(1960) 01 MAD CK 0011
In the Madras High Court
Case No : Appeal No. 33 of 1956

Nadar Bank Ltd., Madurai

APPELLANT

Vs

Canara Bank Ltd. and Others

RESPONDENT

Date of Decision : 21-01-1960

Acts Referred:

Contract Act, 1872 — Section 172, 178

Citation : AIR 1961 Mad 326 : (1961) 31 CompCas 12 : (1960) 73 LW 565 : (1960) 2 MLJ 489

Hon'ble Judges : Ramaswami, J;Anantanarayanan, J

Bench : Division Bench

Advocate : V.V. Raghavan and V. Srinivasan, for the Appellant; T. Krishna Rao, for the Respondent

Final Decision : Allowed

Judgement

Anantanarayanan, J.—This appeal is instituted by the third defendant in the court below, The Nadar Bank Limited, Madurai, against the

judgment and decree of the learned Subordinate Judge of Madurai in O. S. No. 155 of 1952, which was a suit instituted by the Canara Bank Ltd.

(plaintiff) for recovery of a sum of Rs. 21017-6-0, from two merchants, first and second defendants, which was decreed with costs. As the appeal

involves certain interesting questions of law and fact relating to the priority of what are known in mercantile and banking practice as loans upon the

security of goods under the "open credit" system, as against similar advances under the "key loans" system, we shall first set forth the broad and

indisputable facts, before formulating the points that arise for our determination.

2. The facts are that defendants 1 and 2 are members of an undivided Hindu family canying on business in grains and cereals under the name and

style of "V. M. Sankarapandia Nadar" at Madurai. The Madurai branch of the Nadar Bank Ltd. (hereinafter termed the appellant bank) was

giving credit facilities to defendants 1 and 2, as regular customers, for the past nearly 15 years. The accounts show that the last cash credit

transactions of defendants 1 and 2 with the appellant Bank were closed on 22-2-1952. From about 1949, defendants 1 and 2 were also having a

current account with the Canara Bank Ltd, (hereinafter termed the plaintiff bank).

They took "key loans" from the plaintiff bank of Rs. 19500 on 4-1-1952 and Rs. 14500 on 20-2-1952. While matters stood thus, the appellant

bank gave cash credit accommodation to the limit of Rs. 40000 to defendants 1 and 2 for the year commencing from 1-3-1952. Under Ex. B.7,

which is a vital document in the case, the cash credit was obtained upon security of goods under the "open credit system" in the following four

godowns, namely 31 Chintamani Road 5 Gurusadi Lane, 11 Panthadi 7th lane, and 9 Panthadi first lane and also upon the security of certain

immovable property (2 Ponnammal Road), on 20-3-1952, the appellant bank split the credit facilities of defendants 1 and 2 into two categories,

namely, Rs. 20,000 on "open credit" and Rs. 20000 upon "key loan" (Ex. B. 15).

3. On 27-3-1952, the defendants 1 and 2 also approached the plaintiff bank for a "key loan" of Rs. 6600 on pledge of their goods in door No. 9

Panthadi 1st lane (Ex. A. 4). On 4-4-1952, defendants 1 and 2 took a "key loan" of Rs. 14, 350 from the plaintiff bank on pledge of goods in

Godown 11, Pandhadi 7th lane and another godown. Under the "open credit" system and the terms of the agreement Ex. B. 7, the defendants 1

and 2 were bound to submit returns of stock periodically, by the week, and they did not do so after Ex. B. 17 dated 2-4-1952.

On 15-4-1952 a godown clerk of the appellant bank is said to have demanded the statement from defendants 1 and 2 who promised to send it the

next day. As they did not do so, the clerk (D.W. 1) went and inspected the godowns and found the doors of Nos. 9 and 11 locked with the locks

of the plaintiff bank. Subsequently, disputes for priority arose between the two banks, and the appellant bank also filed a criminal complaint against

the first defendant (C. C. No. 1101 of 1952 Sub Magistrate, Madurai). After the plaintiff liled the present suit, a receiver was appointed by the

Court for sale of the goods in the three godowns, and certain realisations have been made, admittedly far below the value of the goods as originally shown.

4. Before proceeding to enunciate the points in controversy, it is necessary to have a clear idea of the features of the "open credit" system and the terms of the agreement Ex. B-7, as well as the features of the "key loan" system. Ex. B. 7, in particular, is of great importance, for this document and the subsequent returns submitted by defendants 1 and 2 to the appellant bank in pursuance thereof Exs. B. 10, B. 11, B. 12, B. 13, B 14, B 16, B. 17 and B. 18 show the true nature of the relationship between the parties, and the character of the advances. Under clause 1 of Ex.B.7 it is specified that--

the goods, produce and merchandise described in general terms in the schedule hereto delivered to the bank under this agreement as security
.....are pledged to the bank or are to be deemed to have been so pledged as security to the bank for the payment by the borrowers of the balance due.

Under clause 3 it is specified that--

the borrowers shall, with the previous consent of the bank, be at liberty from time to time to withdraw any of the goods, produce and merchandise for the time being pledged to the bank, provided the advance value of the said goods, produce and merchandise is paid into the said account or provided the necessary margin required hereunder is fully maintained.

Under Clause 7, it is incumbent on the borrowers, to furnish statements and returns to the bank of the current market value and other particulars of the goods left with them as the bank may require from time to time, and also that they "shall maintain in favour of the bank a margin of 40 per cent on the value of the goods, produce and merchandise". In addition to this, it is not in dispute that the goods were also insured by the borrowers in favour of the appellant bank. The name-plate of the appellant bank was affixed in the respective godowns, in token of pledge. The record establishes this, and it is further clear from the evidence of the clerk (D.W. .1), that the name-plate was there when he inspected the premises on 2-4-1952.

On this aspect, we have no doubt that the borrowers (defendants 1 and 2) played the fraudulent game of suppressing the material particulars from the plaintiff bank, when they obtained advances from that bank, and also of removing the name-plate evidencing the prior pledges to the appellant bank, when the officers of the plaintiff bank visited the premises etc. We might here conveniently state that, under the "key loan" system," to the contrary, the advance is secured by the pledge of goods in the godowns through the simple and effective expedient of putting a lock or seal of the creditor bank on the godowns, the key or keys thereof being retained by that bank. But, naturally, this latter system has the profound disadvantages that it immobilises trade or credit. It is no longer possible for the borrower to deal with the goods, even for a restricted purpose, unless he takes possession of the key from the creditor bank and thus operates upon his stock.

5. In the lower Court, the trial largely centred around two questions : firstly, whether the security of the goods obtained by the appellant Bank upon its advances, amounted to a pledge in law, or to mere hypothecation of movables. It is not in dispute that, in the latter case, a formal pledge later obtained by the plaintiff bank under the "key loan" system will have priority, unless the plaintiff bank had notice of the prior transactions, and was not acting bona fide. The second question was whether the plaintiff bank was a bona fide pledgee without knowledge of the prior transactions, and, if so, whether the appellant bank was not estopped from contending that it was entitled to priority in respect of the realisations effected by the receiver.

Broadly speaking, those are also the points that arise for determination in the appeal. But a further question has been agitated whether under such circumstances, the plaintiff bank would be protected, even if it is not entitled to protection by the operation of any principle of estoppel, because of Section 178 of the Indian Contract Act. There are many other matters arising from the oral and documentary evidence, to which our attention has been drawn. For instance, we have the facts relating to the splitting up of the total credit offered by the appellant bank to defendants 1 and 2, into open cash credit" for Rs. 20,000 and "key loan" for the balance of Rs. 20,000 under Ex. B. 15, and the subsequent developments relating to this.

We have the facts relating to the inclusion of certain Immovable property as mortgage, within the scope of the same advances to the appellant

bank. We have several conflicting statements in evidence about the appearance or disappearance of the name plates of the appellant bank in the

godowns, the kind of enquiry made by the Manager of the plaintiff bank, etc. But a great deal of all this merely obscures and confuses the real

issues. It is essential to keep the basic facts in mind, and to apply the relevant legal principles to those facts, without being misled by what are really

side issues.

6. We are Unable to see how, in the light of the authorities and the decided cases, the agreement under Ex. B 7 can be interpreted as anything

other than a document of pledge, with delivery of possession of the goods. We would here emphasise that, in such a matter, the Form of the

juridical relationship is very important, and that it cannot be divorced from the substance, merely! because, in mercantile practice, there is a certain

flexibility and freedom for the borrower under the "open credit" system. On the contrary, the system seems to have been devised for this very

reason; in effect, it secures for the borrower a certain freedom to deal with the goods, provided a stipulated margin above the value of the advance

is maintained, though the formal character of the pledge is throughout preserved.

Under the "key loan" system, the goods are equally secured by pledge, and in the possession of the creditor bank, but there is far less freedom for

the borrower to deal with the goods in any manner, even with the express permission of the creditor bank, and under its authority, as the keys, of

the godowns are in the physical possession of the bank. We are unable to see how the effect can be denied to the specific averments in Ex. B. 7,

that the entire goods were pledged to the bank, and that (clause 3) the borrower can withdraw the goods, even after maintaining the stipulated

margin, only with the previous consent of the bank.

The weekly statements were also devised to see that the rights of the pledgee were not infringed, while permitting a certain freedom of trade to the

pledger above the margin. The difficulty here arises from a misconception as to the law upon the subject, which appears to be the same both in the

United Kingdom and in this country. (Sections 148 149, 160 172, 173 and 176 of the Contract Act). The law is not that the character of the

pledge is lost, unless the pledgee retains manual possession of the goods offered as security. On the contrary, firstly, as stated by Erie C.J. in

Martin v. Reed, (1862) 142 ER 983, in order to constitute a valid pledge, what is essential is that there must be a delivery of the article, either

actual Or constructive, to the pawnee.

Possession is an equivocal term; it may mean either mere manual possession, or the mere right" to possession."" Also see *Chitty on Contracts*,

Vol.. II, 21st Edn. para 130 at page 73. Constructive delivery will be adequate to constitute a pledge, and it applies to all those cases where the

pledger remains in possession of the goods under this specific authority of the pledgee, or for limited purposes. In *Meyerstein v. Barber*, (1866) 2

C.P. 38, an advance was obtained from a creditor on deposit of two copies of the Bill of Lading, the borrower fraudulently retaining the third

copy, which he used to obtain a subsequent advance from another.

The Bill of Lading was recognised as a symbol of property, and its delivery to the plaintiff in the case was held as effective as delivery of the goods

themselves. *Reeves v. Capper*, (1838) 132 ER 1057 is a case of moveable property (Chronometer) left with the pledger for use, and it was held

that notwithstanding this fact, the possession was Still that of the pledgee. In *North Western Bank Ltd v. Joyn Poynter and Son Macdonalds*, 1895

A.C. 56, it was explicitly recognised that a pledgee may redeliver goods to the pledger for a limited purpose, without thereby losing his rights under

the contract of pledge. Finally, reference may be made to *Ex parte, Hubbard*, 1886 17 QBD 690, which laid, down, that the general property in

the goods pledged may remain with the pledger, but that a special property vested in the pledger, namely, a right of sale of which he might avail

when the occasion arises.

Learned counsel for the plaintiff bank (respondent) is aware of the force of these, decisions, in which the relevant principles of law are clearly

enunciated, and also of the terms of Ex. B 7. There has been some controversy regarding the manner in which the margin is to be calculated under

Ex. B. 7, but this is not really very material, except to determine the final allocations of the amounts realised by the receiver, if the appellant bank is

to have priority. The learned Advocate General for the appellant-bank refers to Section 20(e) of the Trusts Act. and to the explanation to

Section 66 Of the Transfer of Property Act, read with Section 68(b), in order to exemplify the types of margin above value of a loan or advance,

which the law has recognised for certain purposes.

According to the learned Advocate General, the terms in Ex. B. 7, read along with the subsequent returns etc., imply that, if the loan or advance is

Rs. 100, first and second defendants were bound to maintain stocks to the value of Rs. 166-2/3. Upon another interpretation, that value would be

Rs. 140/- alone. But, however, this might be, the right of the pledger to sell the goods above the margin, provided the margin is maintained intact,

is not an unqualified right, according to the contract between the parties.

Learned counsel for the plaintiff bank stresses that, even according to D. W. 1, the first and second defendants had a right to take out the goods

subject to maintaining the margin, under the "open Cash credit" system. But, as we have earlier stressed, the very reason for the emergence of this

system must have been the greater flexibility it obtained for the borrower to operate upon stock, but the term of condition that, even for this, the

prior consent of the creditor bank was necessary, insures the constructive possession as well as the character of pledge. Mr. Vasantha Pai for the

plaintiff bank (respondent) has submitted an elaborate argument in order to show that, in the cases where redelivery of the pledged goods to the

pledger was recognised as not affecting the character of the pledge, it was always for a special purpose.

He refers to delivery of the key of the warehouse in which the goods were stored, as a typical mode (Vide *Hilton v. Tucker*, 1888 39 Ch. D. 669,

and *Grigg v. National Guardian Assurance Co.*, 1891 3 Ch. 206. But we are unable to accept that a hard and fast rule can be laid down that

delivery of the keys of the warehouse is essential to secure constructive possession. Equally, we do not think that there can be any rigid delimitation

of the purpose for which the pledger is permitted to retain possession of the goods.

It may be for personal use, as in (1838) 132 EB 1057. It may be for a limited purpose, such as obtaining possession of goods under a Bill of

Lading, returned to the pledger, so that he might store the articles. It may even be for purposes of sale and the essential test is not the purpose, but

whether the dominion over the goods of the pledgee is retained, and the physical

possession or handling of the goods by the pledgor is under the delegated authority of the pledgee, or is independent. The goods may certainly remain in the pledger's warehouse. As observed in (1862) 142

ER 982,

The warehouse of the vendor has been held to be the warehouse of the purchaser, in order to carry out the intentions of the parties.

A certain difficulty may appear to arise in a case like the present, because, under the "open cash credit" system, the pledgor seems to have virtual

freedom to sell the goods above the margin, so long as the margin is retained, It may be argued that this feature renders the contract one of simple

hypothecation of moveables, of the kind described in *Mulia's Transfer of Property Act*, 3rd Edn. pages 386, 387, and by the learned Judges of

the Calcutta High Court in *Co-operative Hindusthan Bank Ltd. and Another Vs. Surendra Nath Dey and Others*, .

But the true distinction is that the constructive possession of the pledgee over the goods is specifically secured by the terms of the contract, and

that it continues with unabated force throughout. Once this is made clear, it becomes obvious that the freedom of the pledger to sell above is

margin, is still one exercised under the authority of the pledgee, though, in actual mercantile practice, it is this very freedom which the parties, take

to be the advantage of the system. Consequently, we are of the view, upon the authorities, already cited, and discussed, that this is a case of pledge

of the goods to the appellant bank, and not a mere hypothecation of moveables.

7. We must now proceed to the crucial question whether the appellant bank is estopped from advancing the priority of its pledge. For the purpose

of his argument, we shall assume that the plaintiff bank made the required enquiries, though we cannot claim that the record is particularly

satisfactory upon this aspect. The facts appear very much as if there was a race between these two banking institutions for securing custom, with

somewhat of a reckless disregard of plain fact evidencing the prior security to another banking institution. Thus, we do not know if the name plates

of the appellant bank reciting the pledges in their favour were merely ignored by plaintiff bank's officers, or they had been conveniently removed

by defendants 1 and 2. We are not clear if the prior insurance policies were also totally lost sight of. But, however this might be, we shall assume

the bona fides of the plaintiff bank, and the absence of knowledge of notice, and examine this question.

8. The learned Subordinate Judge thought that the rule of estoppel operated, mainly upon the authority of certain observations of this court in

Sreeram Narasiah v. Venkataramayya, ILR Mad 59: (A.I.R. 1919 Mad 779(D)). A Bench of this court observed that when goods were left in the

possession of the mortgagor, a wide door was open for fraud, and that when equities between the innocent pledgee and prior mortgagee had to be

weighed, the preponderance must be given to the later pledgee because the prior mortgagee, by his omission to secure possession of the goods,

had ""facilitated the commission of [he fraud."" But, such a dictum can only apply where the facts are clear that the prior pledgee, having possession

of the goods, lost that possession.

Where that possession was not lost, and it is "imperative to bear in mind that that possession need not be manual but may be constructive, it is very

difficult to see how a subsequent pledgee, even without notice, obtains any preference upon a rule of estoppel. That the pledgee does not release

the pledge by handing over a railway receipt or a bill of lading to the pledger for certain purposes is clear from the authority of the Official Assignee

of *Madras v. Mercantile Bank of India, Ltd.* . The entire question of estoppel in such cases was considered by the Judicial Committee in the AIR

1938 52 (Privy Council) . Lord Wright refers to the broad rule stated by Ashurst J. in *Lickbarrow v. Mason*, (1787) 100 ER 35, to the effect

that

wherever one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain

it.

Lord Weight then observes that this dictum was too wide, and has been dissented from in several decisions subsequently. He also refers to the

observations of Cockburn C. J. to the effect that it the, person in possession under a mere delegated authority, took it upon himself to sell or

pledge the goods to a third party, that will not

divest the owners of his rights as against the third party, however innocent in the transaction the latter party may have been.

9. The Judicial Committee state that the rule of estoppel can only arise where

there is some duty which has not been fulfilled, or some omission of that which the party was bound to do, against whom the estoppel is claimed to operate. Therefore, in the present case, it is really not correct to hold that the plaintiff bank obtained a priority, even though the appellant bank had the prior pledge, because the plaintiff bank had neither notice nor knowledge. That would only be the case where the appellant bank was bound to do something else, for instance, to publish or declare the charge in its favour to all banks, in some manner made obligatory by law. Here again, the fact that the first and second defendants had a virtual freedom to sell the goods above the margin, ought not to be permitted to confuse the issue. Even that freedom was obtainable only as a permission, in strict law, for the appellant bank had clearly to retain its constructive possession over the entire stock in the godowns in order to see that the margin was enforced. In law, the case would be just the same if, under the key loan"" system, the pledger borrowed the key from the pledgee for opening the godowns, and taking out the goods for restricted purposes.

10. We therefore hold that the rule of estoppel cannot operate in this case, to deter the appellant bank from claiming the priority which is otherwise its due.

11. Learned counsel for the plaintiff bank (respondent) has urged a final argument based upon Section 178 of the Contract Act. He points out the, observed by Lord Wright in AIR 1938 52 (Privy Council) the Factors Act was enacted in England only to give a limited protection in such cases for unauthorised sale of goods. But the case relied on by him, namely, *Lloyds Bank Ltd v. Bank of America National Trust and Savings Association*, 1935 2 KB 147, has really no application to the present facts, as that was a case of an agent authorised to sell, who exceeded his authority.

Again, *Appa Rao Vs. Salem Motors and Salem Radios and Electricals*, is not helpful upon the present facts, since that was a case to which

Section 178 of the Indian Contract Act had direct and admitted application. In the present case, the borrowers were not ""mercantile agents"" at all,

either within the definition of Section 2(9) of the Sale of Goods Act or Section 178 of the Contract Act. They were themselves the owners of the

goods, and were not acting as agents in the customary course of business as

agents, either with the appellant bank or later"with the plaintiff bank,
or in any sales of the goods which they might have happened to effect.

They were owners pure and simple, and were dealt with as such by the parties.
Section 178 of the Indian Contract Act cannot apply to the facts of

this case. As observed in *Ah Cheung v. Ah Wain*, AIR 1938 Rang. 243, Section
178 can be relied upon only in cases where "be pledgee is aware

that the: pledger is a mercantile agent. This argument has therefore no force.

12. Under the circumstances, we conclude that the transaction in favour of the
appellant bank is a pledge, and that it has a priority which is not

affected either by any rule of estoppel or by the application of Section 178 of the
Indian Contract Act. We find it somewhat difficult to ascertain

how precisely the margin has to be calculated in the present case, and,
admittedly, the appellant bank has to pledge over 39 Panthadi, and the

plaintiff bank is therefore entitled to exclusive payment in respect of Rs.
5525-5-0. We find that a sum of Rs. 20833-14-0 has to be divided

between the two Banks, in the ratio resulting from our findings, taking the
margin to be the goods worth Rs. 140 must be retained against a loan of

Rs. 100; and, accordingly, we direct that the appeal be allowed and the sum
available be divided as follows: Rs. 13889/4 in favour of the Nadar

Bank (appellant bank) and the Canara Bank (plaintiff bank) Rs. 6944-10-0. Each
party will bear its own costs in the appeal.

13. After hearing learned counsel on both sides, and in the absence of any data
justifying the figures of Rs. 42,085 shown in Ex. B 17 as the final

true-value of the stock, we adopt the figure of Rs. 53,000, which, is referred to
in Ex. B. 35. We desire to add that the oral evidence appears to

indicate that there were no withdrawals or releases subsequently, and hence as
far as we can now ascertain from the record, this figure of Rs.

53000 in Ex. B. 35 must be considered to be the final value and it will
accordingly be substituted for the figure of Rs. 42,085 shown in the

judgment.