
(1941) 09 AHC CK 0006
In the Allahabad High Court
Case No : Miscellaneous Case No. 416 of 1941

Ram Lal

APPELLANT

Vs

Official Liquidator Benares Bank Ltd., (in liquidation)

RESPONDENT

Date of Decision : 26-09-1941

Acts Referred:

Citation : (1941) 09 AHC CK 0006

Hon'ble Judges : Braund, J

Bench : Single Bench

Advocate : Gopalji Mehrotra, for the Appellant; I.B. Banerji for Respondent, for the Respondent

Final Decision : Dismissed

Judgement

Braund, J.—This is an appeal arising in the winding up of the Benares Bank Limited from an order by the Official Liquidator rejecting the Appellant's claim. The question is one which is not entirely free from difficulty.

2. The facts of the matter are these. The Appellant Babu Ram Lal, whom for convenience I shall hereinafter refer to as the "cashier", had for a number of years been employed at the Saharanpur Branch of the Benares Bank. But until 1939 he had not been so employed as the servant of the Bank, but as the employee of one Lala Revti Raman. That possibly was a curious arrangement, but it is accepted on both sides that that was the position. In his capacity as the employee of L. Revti Raman, the cashier had been required by the latter to give him security. That was done in this way. The cashier had maintained a personal deposit account in the Saharanpur Branch of the Bank for a thousand rupees in his own name and had, in effect, charged that deposit account of his own in favour of his employer, L. Revti Raman, as security to answer for his good behaviour. That is made clear if one looks at the pass book of this account in the name of the cashier. A note is found there in these words:

This account is pledged with L. Revti Raman Saheb...as security and the principal

deposit will be paid to the depositor on his written permission....

3. In June, 1939, some re-organization took place in the Bank among its staff with the effect that the cashier ceased to be employed by L. Revti Raman in connection with the Bank's affairs. I am told that L. Revti Raman was himself the treasurer of the Bank and that at this point his own employment as treasurer came to an end with the result that he ceased to employ the cashier. On the 23rd of August, 1939, the cashier, that is L. Ram Lal, applied to the Bank's Agent at Saharanpur for the post of cashier at the Saharanpur Branch directly under the Bank and in that application he offered to make a security deposit of a thousand rupees. On the 3rd of November, 1939, L. Ram Lal was appointed cashier of the Saharanpur Branch. We have a letter from the Bank's Agent of that date in which he says:

....I hereby appoint you as cashier for our Saharanpur office on a salary of Rs. 35 p.m. from today. Please arrange to place at the disposal of the Bank a sum of Rs. 1,000 (Rupees one thousand only) as security deposit.

4. Now at that point it is necessary to see in what way the cashier fulfilled his obligation to furnish the security deposit of a thousand rupees he had been asked for. It is out of that transaction that the present question arises. It will be remembered that he had still standing in his own name the deposit account which had been charged to L. Revti Raman as security so long as the cashier's employment under him lasted. What the cashier did, therefore, was first to obtain from L. Revti Raman a release of his charge over the fund. I have a copy of that letter before me and no objection has been taken merely on the ground that it is a copy. It is in these words :

The Agent

Benares Bank,

Saharanpur.

Dear Sir,

With reference to the amount of Rs. 1,000 (Rupees one thousand only) in fixed deposit account with you in the name of L. Ram Lal and assigned in my favour as security deposit, I hereby release the said deposit and I authorise you to make payment of the amount direct to L. Ram Lal as he is no longer in my service. I have now no concern with the said deposit. The relative pass book is also handed over to L. Ram Lal.

Yours faithfully Sd. Revti Raman,

Treasurer.

5. The effect of that was that the deposit account reverted to the cashier in his own name and free from the charge of Reoti Raman.

6. I do not know the date of that letter from L. Revti Raman to the Bank

releasing the security, but it has been accepted by both sides for the purposes of argument that it was written on or about the 3rd of November, at the time of the appointment of the cashier as the servant of the Bank. The cashier, therefore, satisfied his obligation to furnish a security deposit of a thousand rupees by offering the Bank the deposit account in his own name which had been released by L. Revti Raman in the manner in which I have described. This was effected by certain alterations being made in the ledger account and in the pass book. Up till December, 1939, the deposit account continued to stand in the name of the cashier, but all reference to the charge in favour of L. Revti Raman was deleted in red ink both in the ledger folio and in the pass book and instead the words "security deposit" were added to the account in both places. Then on the 30th of December, 1939, the whole account was closed and we find an entry in the ledger "account transferred to H.O. A/c", that is to the Head Office account. I do not doubt that the effect of these transactions, in form at least, was that the Bank had taken over the cashier's personal deposit account as the security which it had required from him on his appointment as cashier.

7. The question at issue in this case is what was the legal effect of the transaction in the form in which it took place. Before dealing with the law, it is necessary to analyse the transaction a little further. At the instant of time at which L. Revti Raman released his own security over the fund, it no doubt reverted to the cashier as his own unencumbered property. At that instant of time the relationship between him and the Bank was one simply of banker and customer, or, in other words of debtor and creditor. He was, in short a mere depositor in the Bank. The effect of what followed was that the Bank took the cashier's own personal and private deposit as the security which it had demanded and in the way I have pointed out, it was actually transferred out of the cashier's name into the Head Office account, where presumably all the security deposits were kept. I do not think that the actual form of the transaction matters very much. It is the substance and effect of the transaction which we have to look at. It can be treated either as a notional repayment by the Bank to the cashier of the thousand rupees standing to his credit on the deposit account and the immediate re-deposit of that sum by the cashier by way of security; or it can be regarded merely as a transfer by the cashier of the money standing to the credit of his personal deposit account to another account to be held by way of security. Whatever the actual form of the transaction was, the substantial effect of it was that the relationship between the Bank and the cashier was materially altered. The cashier ceased to be a mere creditor of the Bank in the sense of an ordinary depositor and he became an employee of the Bank who had deposited a security deposit. Obviously there is a great difference between the rights of a mere unsecured depositor and the rights of an employee in respect of his security deposit when it comes to a question of winding-up. If the transaction is to be sustained, the effect will have been that by this arrangement the Bank will have converted the account in question from a unsecured deposit account carrying with it the rights merely of an unsecured creditor to a security deposit

account carrying with it the rights of a beneficiary in relation to a trust fund. Or, to put that in another way, the cashier will have, in effect, received back his deposit account in full and will have re-deposited it with the Bank in a different capacity and moreover, in a capacity in which he is no longer a mere creditor but is in the position of a cestui que trust.

8. It is that transaction which is attacked. There are two or three relevant dates. On the 3rd of May 1939 the Company had suspended payment. On the 3rd of August 1939 the winding up petition had been presented and in view of the winding-up order which was made subsequently, the 3rd of August 1939 became the date of the commencement of the winding-up. Ultimately the winding-up order was made on the 1st of March 1940. It will be observed, therefore, from these dates that the transaction I have been discussing took place after the date of the commencement of the winding-up, but before the date of the winding-up order.

9. In those circumstances, the cashier preferred a claim to the Official Liquidator to be paid the amount of his so-called security deposit in full upon the footing that it was a trust fund and as such, never formed part of the assets of the Bank available for distribution among the creditors. The Official Liquidator, however, took the view that the whole transaction was void u/s 227(2) of the Indian Companies Act as a disposition by the Company of its property made after the commencement of the winding-up. If that is true, then, unless the Court should think fit otherwise to order, the transacted will be wholly void ab initio and the result would be that the money in question will still be standing as an ordinary deposit account and the cashier will still be an ordinary unsecured creditor in respect of it. That is what the Official Liquidator has decided.

10. This is a matter which is governed by Section 227(2) of the Indian Companies Act, I have no doubt. I have already at some length set out the details of the transaction. It seems to me that, when examined, it amounted in fact to a "disposition" by the Company of its property. At the moment after the release by L. Revti Raman of his charge the deposit account became the personal property of cashier. The Bank, whether we regard it as a notional repayment to the cashier and a re-deposit by him or as a mere transfer, disposed of it in the sense that they put an end to the old rights relating to him and created and entirely new set of rights. I have not the least doubt that it was a "disposition" by the Company of the money which they utilised in discharging their unsecured debt to the cashier on the deposit account as the prelude to creating the trust fund held on the security deposit account. It extinguished its existing debt by paying it off and took it back in the form of a trust fund. That being so and there being no doubt that it took place after the commencement of the winding-up, it was prima facie void in the sense that it was of an effect at all.

11. But Section 227(2) is a discretionary section by virtue of the words "unless the Court otherwise orders". That gives the Court discretion at any time to make an order in a proper case validating a disposition, notwithstanding that it is one

made after the commencement of the winding-up. The real difficulty in this case consists to my mind, in deciding whether it is one in which the Court ought to exercise its discretion in favour of the Appellant. Now, there are certain authorities which have been decided in relation to the principles by which the Court ought to be guided on this question. But before coming to those cases I think it is right to refer to the under-lying and fundamental principle which runs through the whole of the administration of an insolvent company's winding-up. The fundamental principle is that the assets of the company shall be, so far as is possible and subject to certain well recognized exceptions, distributed *pari passu* between the creditors and subject as aforesaid, that no creditors shall obtain an advantage over any other creditor. That is the fundamental principle underlying all winding-up and insolvency administration and I feel that, in dealing with every question of this kind, it is right to approach it with that in mind. I do not mean to suggest that there are not statutory exceptions and that there are not cases in which in the exercise of a judicial discretion the principle may be departed from. It is, nevertheless, important that the principle should be borne in mind. It has also to be noticed that in this particular case it is impossible to believe--and indeed, it has not been alleged--that the Appellant entered into the transaction in ignorance of the fact that a winding-up petition had been presented. We start, therefore, apart from the question of principle, with the circumstance that the cashier must be taken to have known at all material times that a winding-up petition had been presented and on well-known principles, he must be taken to have known that any disposition by the Company of its property was liable to be void. There is no suggestion from first to last that there was any ulterior motive in the mind of the Appellant and I think it is fair to say that no question of any conscious fraud on the creditors has been raised in the case. It is simply a matter in which one of two innocent parties have to suffer, the Appellant on the one hand or the general body of creditors on the other. Nor in my view, does any question of fraudulent preference arise, because the whole foundation of the transaction is admitted to have been that it was entered into for the purpose of enabling the Appellant to be employed as a cashier and in order that he might give security to the company for his good behavior. I cannot possibly, therefore, find any "view to prefer."

12. Now coming to the authorities, I only propose to deal with three of them. The whole question of the discretion of the Court u/s 227(2) was discussed very fully by three Judges of the Bombay High Court in *Tulsidas Jasraj Parckh v. The Industrial Bank of Western India* (1931) 54 Bom. 718 : AIR 1931 Bom. 2. No useful purpose will be served by referring to the particular facts of that case. The learned Chief Justice in the course of his judgment also took as his point of departure the fundamental principle of the distribution of assets *pari passu* in all insolvency administration. He says at page 738:

Mr. Munshi for the Liquidator has rightly laid stress on these questions of principle and he has indeed urged that if dispositions of, this character of a Company's assets are to be allowed on the mere pretext of giving time, this

would undermine the main principle hitherto governing the distribution of assets in the winding-up of a Company or the insolvency of an individual or firm. This fundamental principle is that in a winding-up or insolvency all unsecured creditors are to be paid *pari passu* and further that the appropriate date for ascertaining their legal position is in the case of a Company the date of the commencement of the winding-up....

13. The learned Chief Justice then at page 752 goes on to point out that, even in the ordinary course of business, there is a sharp distinction between what is permissible after the presentation of a petition and before. There is no doubt that the reason why the Court is given a discretion u/s 227(2) of the Act is that a Company may not be completely paralysed by the presentation of a petition. There are obviously cases and occasions in and on which it is not only legitimate but useful and necessary for a Company to undertake business transactions even after a petition against it has been presented. There are, however, differences between what may be done before and after the presentation of the petition. The learned Chief Justice says:

There is, I think, a dividing line between what is the ordinary course of business before a winding-up petition is presented and what is the ordinary course afterwards. Before a petition is presented, it is in the ordinary course of business for a Company to pay all its debts and incidentally to give security to its Bankers of any overdraft or loan it may arrange. But after a petition is presented, the situation is different. *Prima facie* all debts will have to be paid *pari passu*. Therefore it is no longer in the ordinary course of business to pay one creditor in full to the detriment of his fellow creditors....

14. That does not, of course, refer to the conscious payment of one creditor to the detriment of his fellow creditors. That is covered by the fraudulent preference doctrines of insolvency law. What I venture to think the learned Chief Justice meant was that, even in carrying on its ordinary business in the interval between the presentation of a petition and the making of a winding-up order, the Company must never forget that the principle of *pari passu* distribution among the creditors must prevail in the absence of most exceptional circumstances.

And finally at page 728 the learned Chief Justice applied a test. He said:

The real point then to my mind is to determine what was right and fair between July 24 and 31 when these securities were given. And as the Court's sanction is now asked for *ex post facto*, I think it a fair test to consider whether, the Court would have sanctioned the giving of these securities, supposing it had been asked to do so at the time.

15. The learned Chief Justice, therefore, applied his mind to what would have been the view of the Court had it been applied to for sanction at the time. If I may say so, that is the right test. That case in the Bombay High Court has been approved of and followed in our own Court very recently in the case of the Official Liquidators Gorakhpur Electric Supply Company Limited v. Siemens

(India) Limited Calcutta 1940 A.W.R. (H.C.) 494. The facts of that case are not identical with the one and it is sufficient for me to point out that the principles of the Bombay case were accepted and followed.

Finally, I desire to refer to an English case, *In re Park Ward and Company Limited* (1926) 1 Ch. 828, u/s 205 of the Companies (Consolidation) Act, 1908, which was the section of that Act corresponding to Section 227 of the Indian Companies Act. Unlike the two cases to which I have already referred, this is a case in which the Court allowed a disposition of property to stand. In this case a petition had been presented against the Company for winding up; but, notwithstanding that, the Company borrowed money wherewith to pay its servants and gave a security over the Company's assets to secure the sum borrowed. It turned out that the Company was thereby able to continue its business until the winding-up order intervened and then in the winding-up the business was sold as a going concern. Mr. Justice Romer, as he then was, in the course of his judgment referred to a passage from Lord Cairns's judgment in *In re Wiltshire Iron Company L.R.* 3 Ch. 443 At page 446, Lord Cairns said:

The 13rd section"--that is the equivalent section of the English Act of 1862--"no doubt provides that all dispositions of the property and effects of the company made between the commencement of the winding up (that is the presentation of the petition) and the order for winding-up, shall, unless the Court otherwise orders, be void. This is a wholesome and necessary provision, to prevent during the period which must elapse before a petition can be heard, the improper alienation and dissipation of the property of a company in extremis. But where a company actually trading, which it is the interest of every one to preserve and ultimately to sell, as a going concern, is made the object of a winding-up petition, which may fail or may succeed, if it were to be supposed that transactions in the ordinary course of its current trade bona fide entered into and completed, would be avoided and would not, in the discretion given to the Court, be maintained, the result would be that the presentation of a petition groundless or well founded, would ipso facto, paralyze the trade of the company and great injury, without any counterbalance of advantage, would be done to those interested in the assets of the company.

Mr. Justice Romer in the case before him applied that principle and he decided that the borrowing of the money was, in effect, a matter both of necessity and of prudence and that, in the result, it had been justified by the eventual sale of the business as a going concern.

Now, I have to try to apply those principles to this case and I shall begin by applying that test which the learned Chief Justice of the Bombay High Court himself applied. I bear in mind that this is a case in which no question of fraud arises and I ask myself whether, if the Bank had applied to the Court for sanction to employ the Appellant as its cashier upon the terms that it should convert his ordinary unsecured deposit account into a deposit security account, the Court would knowing the facts have given that sanction. I am compelled to think that

it would not have done so. Inevitably the Court would have had in mind the result of that transaction, namely that its effect was to pay to the cashier the amount of his deposit account in full at a time when it was known that a petition was pending against the Company and when it was certain that, if a winding-up order made, the creditors would not be paid in full. As I have already pointed out, that knowledge was equally available to the parties to this transaction as it would have been to the Court. I have no doubt that there are hundreds of unemployed cashiers whose qualifications are almost as good as those of this Appellant. It is true that he had been employed in dealing with the Company's affairs for some years and to that extent he may have had a special value but I cannot think that the Court would have so far departed from fundamental principle as to have allowed a payment to be made to an unsecured creditor in full at the expense of the other creditors, merely because he was known to be a suitable cashier. This application is an "ex post facto" application and I regret that I can see no ground upon which I can sanction now a transaction which, in my opinion, the Court would not have sanctioned at the time. I have not come to this view upon the ground that there was in any way any sharp practice or unfair dealing on the part of L. Ram Lal. As I have said before, it is one of those unfortunate cases in which one of two innocent parties must suffer. In the result I have come to the conclusion that the principle must prevail--that is the principle of *pari passu* distribution among the creditors. It was not a case of salvage, of real necessity nor of the transaction having been the only means of keeping the Company going. It was a very ordinary transaction in which unfortunately the Company chose as their cashier a man who had a deposit account with it and was in that respect an unsecured creditor. In the result the Applicant obtained an undue advantage over his fellow creditors and for the reasons which I have given at some length, I feel unable to sanction it.

16. For all these reasons, this application must be dismissed.