
(1997) 08 MAD CK 0143
In the Madras High Court

Rehaboth Traders by Partner R. Franklin and Another	APPELLANT
Vs	
Canara Bank and Others	RESPONDENT

Date of Decision : 22-08-1997

Acts Referred:

Citation : (1998) 1 LW 555 : (1998) 2 MLJ 318

Hon'ble Judges : R.R. Jain, J

Bench : Division Bench

Judgement

R.R. Jain, J.—The appellant Rehaboth Traders, a partnership firm, having failed to discharge its liability, was adjudged as insolvent in Insolvency Proceedings No. 34 of 1991. The respondent Canara Bank had advanced loan to the appellant against hypothecation of goods. After adjudication, as the matter was referred to the Official Assignee, the respondents Bank also lodged its claim as secured creditor in Claim No. 127 of 1991 for a sum of Rs. 13,23,588.51 with future interest. However, after holding an enquiry, the Official Assignee held the respondent Bank as unsecured creditor, vide an Order dated 30.11.1993. Aggrieved by the said Order of the Official Assignee, the respondent Bank preferred an appeal in Application No. 140 of 1994 u/s 86 of the Presidency Towns Insolvency Act in the High Court. The learned single Judge, by his detailed Order dated 2.9.1996, allowed the appeal, setting aside the Order of the Official Assignee and directing the Official Assignee to treat the respondent Bank as secured creditor. Aggrieved by this Order, the insolvent-debtor appellant has filed this appeal.

2. The principal bone of contention placed on us on behalf of the appellant insolvent is that, as at the time of commencement of insolvency, the appellant was in exclusive possession and disposition of the properties that are alleged to have been hypothecated with the respondent, the same shall form part of property of the insolvent divisible amongst the creditors, and shall be made available for the pro rata distribution. In support of this contention, the learned Counsel for the appellant has placed reliance upon Section 52(2)(c) of the

Presidency Towns Insolvency Act, 1909. Since the entire controversy centers around the interpretation of Section 52(2)(c) of the Act, it will be appropriate to reproduce Section 52(2)(c) as under:

52. Description of insolvent's property amongst creditors: (1) The property of the insolvent divisible amongst his creditors, and in this act referred to as the property of the insolvent, shall not comprise the following particulars, namely:

(a) property held by the insolvent on trust for any other person;

(b) the tools (if any) of his trade and the necessary wearing apparel, bedding, cooking vessel, and furniture of himself, his wife and children, to a value, inclusive of tools and apparel and other necessities as aforesaid not exceeding three hundred rupees in the whole.

2. Subject as aforesaid, the property, of the insolvent shall comprise the following particulars, namely:

(a) all such property as may belong to or be vested in the insolvent at the commencement of the insolvency or may be acquired by or devolve on him before his discharge;

(b) the capacity to exercise and to take proceedings for exercising all such powers in or over or in respect of property as might have been exercised by the insolvent for his own benefit at the commencement of his insolvency or before his discharge; and

(c) all goods being at the commencement of the insolvency in the possession, Order or disposition of the insolvent, in his trade or business by the consent and permission of the true owner under such circumstances that he is reputed owner thereof:

Provided that things in action other than debts due or growing due to the insolvent in the course of his trade or business shall not be deemed goods within the meaning of clause (c): provided also that the true owner of any good which have become divisible among the creditors of the insolvent under the provisions of Clause (c) may prove for the value of such goods.

3. The learned Counsel for the respondent Bank has repelled this contention and is also challenging the maintainability. Consequently, before dealing with the rival contentions on merits, we would deal with the preliminary objection about the maintainability of this appeal.

4. It is strenuously argued on behalf of the respondents Bank that upon a debtor being adjudged as insolvent, an Official Assignee became in charge of the entire affairs of the debtor. Consequently, it shall not be open to the debtor to prefer such an appeal substantially directed against an Order of the Official Assignee. At the outset, we may say, and it is true that after adjudication, the Official Assignee enters into the shoes of the debtor for the purpose of management and distribution of properties and affairs. But, ultimately, the insolvent debtor is the

interested and affected party by whatever Order s passed in relation to affairs, administration and disposal of the properties. The manner and method of disposal and disposition of properties and division amongst the creditors may ultimately affect the insolvent's valuable right of getting discharged u/s 38 of the Act. As a cardinal rule, every interested and affected party has right to agitate disputed questions before appropriate forum, if not agitated by the person, who by operation of law, enters into the shoes of the debtor insolvent and it is obligatory upon him to invoke such right. In this case, the Official Assignee could have challenged the Order , but since he has failed to do so, it has rightly been challenged by the insolvent debtor. Hence, in the facts and circumstances of this case, we hold that the appeal is maintainable.

5. It is true that the word "hypothecation" has not been expressly defined in the law of contracts. But, the scope of the word "hypothecation" has been explained in catena of judgments of the Honourable Apex Court, as well as various High Courts in the country. It is also true that there is no transfer of interest of property in the goods by the hypothecator to the hypothecatee. The concept of hypothecation simplicitor involves creation of an equitable charge in favour of the hypothecatee, and delivery of possession is not a sine qua non for the creation of charge. The possession of goods is always left to the hypothecator to enable him to deal with the goods, subject to the rights of the hypothecatee. In other words, the hypothecator is simplicitor an agent of the hypothecatee, the Bank which shall be deemed to be and is always in constructive possession of the security, namely the goods hypothecated. In this case also, execution of hypothecation agreement is not disputed. Factum of hypothecation of goods is also not disputed (except that goods lying in all godowns are not hypothecated). Section 52(2)(c) of the Act involves the concept of reputed ownership whereby a true owner pledges goods in his possession, Order or disposition of the insolvent in his trade or business with his free will, consent and permission and that if such goods are found in possession of the insolvent at the commencement of insolvency the insolvent shall be treated as reputed owner of the goods and the good scan be made available for division amongst creditors. But, in this case, the doctrine of reputed ownership cannot be made applicable because the respondent Bank does not claim to be the owner of the hypothecated goods but being a secured creditor claims the goods as security and preference for adjustments against the dues over all other creditors. The concept of reputed ownership involves concept of double ownership i.e., real and ostensible ownership by conduct, of course, with consent of real ownership. These ingredients are absent in the present case.

6. Hypothecation of goods is nothing but an extended form of pledge and "to pledge" means "to give the goods as security". Hypothecation means pledge of goods i.e., to give goods as security without possession. In this case also, giving of goods in security is not in dispute and the Bank has a defined right and special privilege, advantage or benefit qua said goods. Under these circumstances, we have no hesitation in holding that the respondent's dues are secured by the hypothecated goods which, though are in physical possession of the debtor, but

are in constructive possession of the creditor respondent Bank by virtue of a binding agreement in existence between them.

7. An attempt is made by urging that the concept of hypothecation involves exhibiting a board at the relevant place that the goods are hypothecated, whereas at the commencement of insolvency, such board was not found when the Official Assignee took over the management. Hence, the right shall be deemed to have been waived/lost. An attempt is also made to create doubt about the legality and validity of the agreement owing to alleged unilateral additional and alterations. But, both the issues have been dealt with in detail by the learned single Judge in paragraphs 5 and 6 of his judgment. We are also in complete agreement with the view expressed, and reject both these contentions.

8. Various judgments have also been cited by the learned Counsel for the appellant in support of his contentions. The same were also cited before the learned single Judge, who has dealt with in their proper perspective. Even then, a brief reference is also made hereunder:

(i) In *The Bank of Bihar Vs. The State of Bihar and Others*, , it is held that so long as claim of the pawnee is not satisfied, no other creditor of pawner has any right to take away the goods or its price, meaning thereby, the pawnee is secured and has preferential right over other creditors. In the present case also, the relationship between the parties is that of pledger and pledge following from "open cash credit" facilities, and though the physical possession is with the appellant debtor, yet, under an agreement, the constructive possession is with the respondent Bank. It is always not necessary to have delivery of keys of the warehouse for securing constructive possession. In such cases, possession has little relevancy, but what is relevant is dominion over the goods. The debtor has only a delegated authority to deal with the goods subject to rights of the hypothecatee.

(ii) In the decision report in the case of *Syndicate Bank v. Official Liquidator Prashant Engineering Co. P. Ltd.* 1986 C.C. 59 301, though the assets of the insolvent debtor were hypothecated with the Bank, the Bank was held to be unsecured creditor, because irrespective of hypothecation, the Bank had filed suit and had obtained money decree and the claim was with respect to money decree only. It is held by the court that as the decree was obtained long after the sale, and as the rights of the Bank under hypothecation agreement stands merged in the decree, the Bank could only prove its claims when the claims are invited in the course of winding up, ranking with unsecured creditors.

(iii) In a decision reported in the case of *Bank of Maharashtra Ltd., Poona v. Official Liquidator*, High Court Buildings AIR 1969 Mys. 280, it is held that because of hypothecation of pledge of movable goods, the creditor is entitled to retain possession and exercise the right of private sale without intervention of the court, in other words, enjoys special privileges and advantages.

(iv) In the case of *State Bank of India v. Quality Bread Factory, Batala and Ors.*

AIR 1983 P&H. 244 the court was called upon to deal with the scope of cash credit facility by the Bank under key loan system and open credit system. It was held that despite hypothecation of goods under cash credit facility, the goods were lost by negligence of pledgee and thereby, the surety stood discharged. The tenor of observation in paragraph 17 of that judgment is that, in case of hypothecation of goods, the creditor has preferential right of recovery.

(v) this Court, in the case of *The Nadar Bank Ltd., Madurai v. The Candrd Bank Ltd.* (1960) 2 M.L.J. 489 has held that in case of hypothecation of goods, the juridical relationship between the parties is that of pledge and pledge, though the system was termed "open cash credit" in mercantile practice, and as one of the essential ingredients of pledge is delivery of goods either actual or constructive, constructive delivery will be adequate to constitute a pledge and it applies in all cases where the pledger remains in possession of the goods under the specific authority of the pledge for limited purpose.

(vi) In *Bank of India Vs. Binod Steel Ltd. and Another*, , it is held that in case of pledge and mortgage of movables by a company in favour of Bank, though actual possession is left with the debtor, it is for and on behalf of the Bank which is secured creditor, and the movables cannot be attached with the claim of other creditors without satisfying the claim of the Bank.

(vii) Even the Andhra Pradesh High Court also, in the case of *The State of Hyderabad, Secunderabad Branch v. Susheels and Ors.* AIR 1980 A.P.I has held that in case of pledge of goods, the Bank is entitled to satisfaction of its debts in preference to other creditors, who shall be entitled to the surplus money only after satisfaction of the Bank's dues.

(viii) The Delhi High Court, in *Gopal Singh Hira Singh v. Punjab National Bank and Anr.* AIR 1976 Del. 115 drew distinction between the word "pledge" and "Hypothecation of goods" and the scope of right in a case where the possession of goods is lost.

9. Apart from the aforesaid judgments, in a recent unreported judgment of the Supreme Court delivered in Civil Appeal Nos. 16778 - 16780 of 1996, it has been held that in case of hypothecation of goods, the Bank ought to be allowed to recover its dues by sale of hypothecated goods in preference to other creditors.

10. In humble agreement with the view taken by different Courts, we also hold that in case of hypothecation of goods, the Bank Creditor has preferential right, though the debtor is in physical possession. Court attention is also drawn by the respondent's counsel to the Commentary on "The Banking Law in Theory and Practice" by S.N. Gupta. According to the Commentary under the caption "Pledge and hypothecation-distinction" at page 575 it is held that in the case of hypothecated goods, the actual physical possession of the goods with the borrower is as an agent of the Bank and in that sense, it can be said that is in the actual possession of the Bank. The Commentary at page 589 under the caption The status of the Bank is based on judgment of the Supreme Court

reported in *The Bank of Bihar Vs. The State of Bihar and Others*, which we have already dealt with in paragraph supra. The scope of key loan system and open credit system is dealt with at page 580 of the Commentary. At page 595, it is stated that in case the rights of a hypothecatee are so understood and limited, he has a right to claim preference over a public debt in the nature of tax dues to the State. Thus, this also lends support to the case of the respondent Bank.

11. In view of the aforesaid circumstances, we are in complete agreement With unimpeachable reasonings adopted by the learned single Judge, and hold that in case of hypothecation of goods, the Bank shall be treated as a secured creditor and shall have preferential right of recovery in relation to other creditors. Any other interpretation to this relationship would betray the mercantile - trust and faith as is understood and followed in practice since *centrus*. Not only this, but the interest of banking institutions essentially dealing with public money would also be jeopardised.

12. In the result, we find no merits in this appeal, and the same is dismissed with no Order as to costs. The judgment of the learned single Judge is affirmed. Consequently C.M.P.No. 14244 of 1996 is also dismissed.