

(1926) 02 BOM CK 0016
In the Bombay High Court
Case No : First Appeal No. 261 of 1925

The Bank of Baroda

APPELLANT

Vs

H.B. Shivdasani

RESPONDENT

Date of Decision : 02-02-1926

Acts Referred:

Companies Act, 1956 — Section 283

Citation : (1926) 28 BOMLR 689 : (1926) ILR (Bom) 547

Hon'ble Judges : Norman Macleod, J;Coyajee, J

Bench : Division Bench

Final Decision : Allowed

Judgement

Norman Macleod, Kt., C.J.—The applicant, as Official Liquidator of the Whittle Spinning and Manufacturing Company Limited, filed this application, u/s 283 of the Indian Companies-Act, in the Court of the District Judge of Ahmedabad, asking for a declaration that the floating, charge given to the Bank of Baroda by the Company, on June 13, 1924, was invalid as having been granted within three months of the commencement of the winding up.

2. The instrument creating the charge in dispute, Exhibit 77/5, was executed on June 13, 1924, by two Directors in favour of the Bank.

3. A petition for the compulsory winding up of the Company was presented on August 7, 1924, Therefore, it is not denied that the charge was given within three months of the commencement of the winding up, and, as the District Judge has pointed out, any attempt to prove that the Company was solvent at the time the charge was created was bound to fail.

4. So the only question in issue was whether Exhibit 77/5 created a floating charge. The District Judge answered this question in the affirmative and declared the charge to be invalid, ordering the Bank to bear the whole costs of the application, as in his opinion the Bank had taken up an untenable position and wasted public time in defending the application.

5. The Bank has appealed.

Exhibit 77/5 runs as follows :-

In consideration of your Bank advancing to us on loan two lacs we have deposited and pledged with and to the Bank as security for the repayment of the loan with interest thereon at seven and a half per cent. per annum with quarterly rests all the liquid assets including stock in-process now or at any time hereafter stored by us in the godowns and the Mill premises situated in Broach District, the keys of which godowns have been delivered to the Bank and shall remain in the possession of the Bank, which liquid assets including stock and stock-in-process we declare to be our absolute property and not to have been charged or incumbered in any way whatsoever. And we have handed to you our promissory note for the sum of Rupees two lacs (Rupees 2,00,000) payable on demand and bearing interest at the beforementioned rate of seven and a half per cent. per annum, and all moneys and interest from time to time due by us to the Bank shall be recoverable by the Bank in Bombay or Ahmedabad or elsewhere on demand, but it is understood that if we faithfully perform and observe all the undermentioned conditions, the Bank will not demand repayment of the moneys due by us hereunder for the fixed period of twelve calendar months from the date of the abovesaid Promissory Note dated November 14, 1923, unless the Bank shall at any time within that period consider that the goods deposited with and pledged to it do not form adequate security for the money due by us, and as to this the Bank shall be the sole Judge and shall decide. Interest on the said loan shall be paid at the end of each third calendar month following the date of the advance.

6. Then follow certain conditions. Inter alia, the Company Was not, during the continuance of the security, to pledge or otherwise charge or encumber any of the goods pledged to the Bank. The Company was to maintain the stock at a value thirty-three and a half per cent. in excess of the amount due for the time being on the security.

7. The Company was to keep the goods pledged to the Bank fully insured.

8. In certain events the Bank was to be at liberty to sell or dispose of the goods pledged.

9. In the event of the goods deposited and pledged being partially or wholly destroyed by fire, the Bank was to recover the full amount of the insurance monies and apply them towards the liquidation of the debt due to the Bank.

10. The Company were to pay the Bank regularly every month Rs. 45 to defray the expenses of a clerk and a peon to be placed in charge of the liquid assets including stock and stock-in-process at the godowns and mill premises by the Bank, and to hold possession of the goods deposited.

11. Reliance has been placed by the respondent on the following Resolution passed by the Board of Directors at a meeting held on June 12, 1924:-

Letter from the Bank of Baroda regarding security of their loan of two lacs was placed before the Board and discussed. Resolved that a floating charge on the liquid assets of the Company be given to them and that two of the Directors sign the Bank Papers.

12. Obviously, we are not concerned with a resolution of the Board, but with the proper construction to be placed on the document actually signed. None of the Directors was called to explain whether the Board understood the real legal significance of the term "floating charge." On the other hand, Mathew Desouza, an accountant in the Bank, deposed that Ganpatram R. Pandya was sent by the Bank to take charge of the liquid assets. Ganpatram deposed that he took possession of the liquid assets on June 14, Ratanlal Karkun went with him to be left in charge. A list of the stock was taken and signed by the Company and at prominent places the Bank's Boards were put up, Thereafter Ratanlal sent weekly returns. No one could remove anything from the goods in charge except with Ratanlal's permission.

13. It may also be mentioned that in Suit No. 478 of 1924, filed by a shareholder against the Agents and Directors, a Receiver was appointed, but that appointment made no difference to the position of the Bank with regard to its possession of the liquid assets, and its clerk was retained in charge thereof. I should have thought myself there could be no difficulty in holding that Exhibit 77/5 created a pledge and not a floating charge. Certain specified goods were pledged by handing over possession to the pledgee after the goods pledged had been inven-toried. The Company agreed to maintain the goods in the godowns at a value of thirty-three and a half per cent. above the amount for the time being due, and as no goods were allowed to be removed without the consent of the Bank's clerk in charge, it was his duty to see that the goods in the godown were maintained at their prescribed value.

14. In Governments Stock and other Securities Investment Company v. Manila Railway Co. Limited [1897] A.C. 81 the Manila Railway Company issued debentures by which it undertook to pay the principal at a distant day and interest on fixed days half-yearly and charged by way of floating security all its property present and future. A condition endorsed on the debentures provided that notwithstanding the said charge the Company might, in the course of and for the purpose of its business, sell or otherwise deal with its property until default should be made in payment of interest for three months after the same should have become due, or until an order or resolution for winding up. After an instalment of interest had been due for more than three months, before the debenture-holders had taken any step to enforce their security, the Company by an issue of bonds mortgaged specific assets.

15. It was held, upon a construction of the condition, that the debenture-holders were not entitled, on the facts stated, to an injunction restraining the Company from paying interest to the bond-holders.

16. It was contended for the debenture-holders that, at the expiration of the three months, the floating charge became fixed and the Company would not deal with the property to the prejudice of the bond holders.

17. Lord Macnaghten said (p 86): -

A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying Condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes. His right to intervene may of course be suspended by agreement. But if there is no agreement for suspension, he may exercise his right whenever he pleases after default.

18. In *Illingworth v. Houldsworth* [1904] A.C. 355a Company, by way of security to guarantors, assigned by deed all its present and future book debts, with the benefit of all securities for the same to a trustee in trust for the guarantors. The deed contained no express provision against possession being taken by the trustee, but declared that the trustee should at any time, if required by the guarantors, give notice of this assignment to the Company's debtors, but that it should not be incumbent on the trustee to give notice unless he thought fit; with provisions that the trustee might at any time give notice, appoint a Receiver, and exercise the statutory power of sale, but mean while should not be answerable for allowing the Company to receive its book debts. It was held, that, upon a true construction of the deed, it was clearly intended that the Company shall carry on its business in the ordinary way and receive the book debts for that purpose, and that the deed was a floating charge within the meaning of Section 4 of the Companies Act, 1900, and void for want of registration in a question between the trustee and a creditor of the Company. Lord Macnaghten said (p. 358):-

With regard to the criticism which Vaughan Williams L. J. passed, not I think unkindly, on some words of mine in the *Manila case*, I only wish to observe that what I said was intended as a description, not as a definition, of a floating security. I should have thought there was not much difficulty in defining what a floating charge is in contrast to what is called a specific charge. A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.

19. The appellant before us has placed some reliance on certain passages of Lord Halsbury's judgment in the same case. The learned Lord Chancellor said (pp. 857, 358):-

I do not " think it necessary to give an abstract definition of what a floating

security is; it is enough to say that this instrument is one, and I think it is one for many reasons. In the first place you have that which in a sense I suppose must be an element in the definition of a floating security, that it is something which is to float, not to be put into immediate operation, but such that the company is to be allowed to carry on its business. It contemplates not only that it should carry with it the book debts which were then existing, but it contemplates also the possibility of those book debts being extinguished by payment to the company, and that other book debts should come in and take the place of those that had disappeared. That, my Lords, seems to me to be an essential characteristic of what is properly called a floating security. The recitals, I agree with Cozens-Hardy L.J., are not without their importance. They shew an intention on the part of both parties that the business of the company shall continue to be carried on in the ordinary way—that the book debts shall be at the command of, and for the purpose of being used by, the company. Of course, if there was an absolute assignment) of them which fixed the property in them, the Company would have no right to touch them at all, The minute after the execution of such an assignment they would have no more interest in them, and would not be allowed to touch them, whereas as a matter of fact it seems to me that the whole purport of this instrument is to enable the company to carry on its business in the ordinary way, to receive , the book debts that were due to them, to incur new debts, and to carry on their business exactly as if this deed had not been executed at all. That is what we mean by a floating security.

It appears to me, notwithstanding the argument we have heard, that it is impossible to doubt that the bargain between the parties which is evidenced by this instrument) is one which could only be carried out at all by its being a floating security such as I have indicated, and which must comprehend those incidents.

20. The first incident mentioned by their lordships was that the security was not to be put into immediate operation. In this case the security was put into immediate operation by the Bank taking possession of the Company's godowns. But the fallacy in the respondent's argument is in thinking that there can be no fixed security if the intention of the parties is that the business of the party executing the charge is to be carried on in its ordinary way. Even then it may be said that this was not the intention of the parties in this case, since the Company, whenever it wanted to take any goods out of the godowns, would have had to obtain the consent of the Bank's clerk, and any one coming on to the Company's premises would be able to observe that it had not free access to its godowns. If it be contended that this was not a restriction sufficient to allow it to be said that the Company was not carrying on its business in its ordinary way, the answer is that the nature of a fixed charge cannot be altered so as to become a floating security merely because in spite of the charge the business of the Company continues to be carried on. Apart from that the judgment I have just referred to must be read in the light of its own facts.

21. There is an elementary distinction between the book debts of a Company and the stocks in its godowns. If, after an assignment of its book debts, immediate notice as part of the transaction is given to the debtors to pay to the assignee, the business of the Company could not be carried on in the ordinary way, whereas in this case the possession by the Bank of the stock in the godowns could not prevent the business being carried on so long as the stocks were kept up to the prescribed value.

22. In *Evans v. Rival Granite Quarries, Limited* [1910] 2 K.B. 979 it was held that a debenture constituting a floating security over the undertaking and assets of a Company did not specifically effect any particular assets until some event happened or some act on the part of the mortgagee was done which caused the security to crystallize into a fixed security.

23. Fletcher Moulton L. J., after citing the judgments of Lord Halsbury and Lord Macnaghten to which I have referred, said (p. 994):-

I think that Lord Macnaghten was here keeping in view the two characteristic features of floating charges-(1.) the non-permanence of the property which is the subject of the charge, and its constant change from time to time, and (2) that a floating charge does not of itself fasten and settle even on the property existing at the moment. This explanation removes all difficulties arising from decisions which speak of a floating charge as an existing charge. It is an existing charge, and is rightly termed so, but care must be taken to remember that it has not settled down and fastened on the property which is the subject of the charge, I find no difficulty in grasping such a concept

24. And Lord Buckley L.J. said (p. 999):-

The outcome of the decision may be thus summarized. A floating security is not a future security; is a present security, which presently affects all the assets of the company expressed to be included in it. On the other hand, it is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. A floating security is not a specific mortgage of the assets, plus a license to the mortgagor to dispose of them in the course of his business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallize into a fixed security.

25. It is clear then that in this case there was a mortgage of specific assets, with a license to the mortgagor to dispose of them in the course of its business subject to prescribed conditions. In the language of Buckley L.J., therefore, it is perfectly clear that the charge created by the document of June 13, 1924, was not a floating; charge. In my opinion, therefore, the appeal should be allowed and the application of the liquidator dismissed with costs throughout.

Coyajee, J.

26. I agree.