

Case No. 13

1997 (II) CTC 494

IN THE HIGH COURT OF MADRAS

Shivaraj Patil and R.R.Jain, JJ.

O.S.A.No.253 of 1996

22.8.1997

Rehaboth Traders, by Partner R. Franklin and another

Appellants

Vs.

Canara Bank, Anna Nagar East, Madras-600 102
and 2 others

Respondents

Hypothecation - pledge of goods without possession - creditor has construtive possession - Hypothecatee can recover dues by sale of hypothecated goods in perference to other creditors.

CASES REFERRED

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|--------------------|-----|-------------------|--------|
| 1986 (59) C.C. 301 | (8) | AIR 1976 Del. 115 | (8) |
| AIR 1983 P & H 244 | (8) | AIR 1971 SC 1210 | (8,10) |
| AIR 1980 AP1 | (8) | AIR 1969 Mys. 280 | (8) |
| AIR 1977 MP 188 | (8) | 1960 (2) MLJ 489 | (8) |

M/s. T.Ramakrishnan, M.Ramachandran, Advocate for Appellants.

M/s. L.Jayakumar (For R-1), Mr.T.P. Parameshwaran, Official Assignee (For R-2)
Advocates for Respondents.

O.S.A. DISMISSED

ORDER

R.R.Jain, J.

1. 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 respondent Bank also lodged its claim as secured Claim in No.127 of 1991 for a sum of Rs.13,23,588.51 ps. 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 under Section 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 principle 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 instalment 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 accessories 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 of 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 with in the meaning of clause (c):

Provided also that true owner of any goods 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 respondent Bank that upon a debtor being adjudged as insolvent, an official assignee becomes incharge 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 orders 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 under Section 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, has rightly been challenged by the insolvent 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 his goods in 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 goods can 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 else 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 additions 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 v. The State of Bihar and others**, AIR 1971 S.C. 1210, 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 pledgor and pledgee flowing 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 reported in the case of **Syndicate Bank v. Official Liquidator, Prashant Engineering Co. P. Ltd.**, 1986 (56) C.C 30, 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 has 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 Mysore 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 M/s. Quality Bread Factory, Batala and others**, 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 Canara 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 pledgor and pledgee, 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 pledgor of the pledgee for limited purpose.

(vi) In **Bank of India v. M/s. Binod Steel Ltd., and another**, AIR 1977 MP188, 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 Bank of Hyderabad, Secunderabad Branch v. Susheels and others**, AIR 1980 A.P.1, 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 **M/s. Gopal Singh Hira Singh v. Punjab National Bank and another**, 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 judgment, 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. Our 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 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 v. The State of Bihar and others**, AIR 1971 SC 1210 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 light of the aforesaid circumstances, we are in complete agreement with the 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 centuries. Not only this, but the interest of banking institutions essentially dealing with public money would also be jeopardized.

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