

Privy Council Appeal No. 62 of 1943
Allahabad Appeal No. 1 of 1939

Lakshman Prasad - - - - - *Appellant*
v.
John and others - - - - - *Respondents*
John and others - - - - - *Appellants*
v.
Lakshman Prasad and others - - - - - *Respondents*
Consolidated Appeals

FROM
THE HIGH COURT OF JUDICATURE AT ALLAHABAD

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF
THE PRIVY COUNCIL, DELIVERED THE 1ST MARCH, 1945

Present at the Hearing:

LORD THANKERTON.
LORD SIMONDS.
LORD GODDARD.
SIR MADHAVAN NAIR.
SIR JOHN BEAUMONT.

[*Delivered by* LORD SIMONDS]

These consolidated appeals from a decree of the High Court of Judicature at Allahabad dated the 3rd August, 1938, which varied a decree of the Subordinate Judge at Agra dated the 27th April, 1931, raise the question whether the appellant Lakshman Prasad (who will be called "the appellant") is entitled as against the respondents, the holders of debentures issued by an Indian limited company known as Agra United Mills, Ltd., and herein called "the Company", to any and what priority over such debentures in respect of moneys which had been borrowed from him by the receiver appointed in a suit brought by such respondents to enforce their security. The Subordinate Judge held the appellant entitled to priority in respect of all the property subject to the charge, whether fixed or floating, created in favour of the debentures: the High Court limited the priority to the property subject to the floating charge. The appellant seeks to restore the order of the Subordinate Judge, the respondents to deprive him of his priority even in respect of the property subject to the floating charge.

The Company was formed in the year 1920 with a nominal capital of Rs.150.00,000, of which Rs.65.00,000 were issued, for the purpose of working certain cotton and other mills which had previously belonged to the respondents or some of them. In the same year the Company issued 200 first mortgage debentures of Rs.25,000 each bearing interest at 8 percent. per annum. These debentures, which were in common form, were secured by a trust deed dated the 8th August, 1923, which contained (a) a specific charge on certain immoveable and other assets of the Company, and (b) a floating charge on the rest of its property and undertaking. In and after the year 1925 the Company also obtained financial assistance from the appellant's father, Rai Bahadur Seth Suraj Bhan (whose heir and legal

representative he is), under the terms of an agreement dated the 9th November, 1925. This agreement, which was of an elaborate character, provided (*inter alia*) for the lender having a lien for moneys advanced by him on raw materials in the Company's godowns and other materials, products and property as therein specified.

In 1927 the trustees of the debenture trust deed filed a suit (No. 84 of 1927) in the Court of the Subordinate Judge at Agra to enforce this security and in that suit on the 30th November, 1927, one, P. N. Raina, was on the application of the plaintiff trustees appointed receiver of the property and undertaking of the Company. The case was presented to the Judge, and was accepted by him, as one of grave urgency, in which the appointment of a receiver was necessary for the protection of the property. It was alleged that the Company had not been able to pay its staff and mill hands for at least three months and that the mill hands had therefore gone on strike, creating a disturbance which threatened the safety of the Company's property. On the following day, the 1st December, 1927, upon a report made by the receiver the Court made a further order in these terms:—

"The Mill-hands have to be paid and from the letter of the District Magistrate it appears that the Mill-hands have been promised their dues, and if they do not get their salaries then there is every chance of a riot and disturbance at the Mill hands. The Mills are about to file an appeal. In case Messrs. Suraj Bhan and Kunwar Ganesh Sinha decline to pay the money which they promised, then you can sell such properties which is admittedly theirs or raise money on such terms as you think proper. The plaintiffs should come forward to co-operate with you. The money which will be paid by Messrs. Suraj Bhan and Kunwar Ganesh Singh or any one else will confer on them the lien which the Mill-hands have on the property which is in the Mill premises."

It appears that Messrs. Suraj Bhan and Kunwar Ganesh Sinha did "decline to pay the money which they promised", whatever their obligation may have been. The receiver was therefore by the order authorised to raise money on such terms as he might think proper. Their Lordships entertain no doubt that under this authority the receiver could validly raise money by a charge on the Company's property ranking in front of the debentures. It is not to be supposed that a lender could be found to advance money on any other terms than that he should have priority for the sums advanced by him for the salvage of the property.

Acting on the authority of this order the receiver on the 4th December, 1927, entered into an agreement with the appellant's father which was in the following terms:—

"I have been appointed Receiver by the Court of the Additional Sub-Judge Agra, in suit No. 84 of 1927—Major A. John *versus* The Agra United Mill Limited, and under an order, dated the 30th of November and 1st December, 1927, the Court has authorised me, the executant, to contract a sufficient amount of loan and pay off the salaries of the labourers, and to run the Mill so far as possible. Accordingly I have made, Seth Suraj Bhan Rai Bahadur, who has been financier of the mill from before and has invested money in it, willing to advance to me at this time Rs.31,000 in cash bearing interest at annas 12 per cent. per month, on promise of paying back the amount after six months, so that salaries of the employees and labourers may be paid and the said Seth Sahab may take away all the movable property, such as bales of prepared yarn, grain, flour, *maida* (fine flour), cotton, bales, packing materials, waste and other goods under preparation, *i.e.*, under process, which lie within the limits of the Mill and which are stated by the Seth Sahab to be owned and purchased by him. Accordingly the parties have come to an agreement. I, the executant, have received Rs.31,000 in cash from Seth Suraj Bhan, Rai Bahadur, the proprietor of firm Seth Chunni Lal, resident and *rais* of Belanganj, Agra. As regards these goods it has been agreed upon that as there is no opportunity for sufficient enquiry at this time, hence in future if these goods will be proved to be the property and to have been purchased or under lien of Seth Sahab aforesaid, then within 10 days of the said decision I shall hypothecate to Seth Sahab aforesaid to his satisfaction, sufficient property worth at least Rs.60,000. If these goods will not be proved to be the property or under lien to Seth Sahab aforesaid, then he (Seth Sahab aforesaid) will set-off the sum of Rs.31,000 towards the price of the said goods and Seth Sahab shall have the same right and lien in respect of this amount of debt and only to that extent as the employees and labourers have in respect of these goods according to law and justice. The remaining goods aforesaid or

the market value of the same, if any, shall after setting off this debt, be paid by Seth Sahab aforesaid to me, the executant, and shall be liable for the same. All these proceedings have been taken under the order of the Court of the Additional Subordinate Judge of Agra, hence there is no personal liability of me, the executant, in any way."

It is necessary to state this agreement in full since it appears to their Lordships that the rights of the parties depend upon a proper appreciation of its effect and that the High Court has in this respect fallen into error. It is not in dispute that the sum of Rs.31,000 was duly paid to the receiver or that this sum was applied by him in the manner contemplated by the agreement or that the goods therein referred to were proved to be the property of the lender and were in due course removed by him. From these facts two consequences follow. In the first place it is clear that that part of the agreement which begins with the words "If these goods will not be proved to be the property or under lien to Seth Sahab" did not come into operation and therefore the question what "right or lien" the "employees or labourers" might have "in respect of these goods according to law and justice" does not arise. In the second place it is clear that the obligation contained in the immediately preceding sentence of the agreement did become effective and the receiver became bound to "hypothecate to Seth Sahab aforesaid to his satisfaction sufficient property worth at least Rs.60,000".

In these circumstances their Lordships consider that the judgment of the High Court proceeds upon a wrong basis. The terms of the agreement, by reference to which the learned Judges of that Court have determined the issue, may be assumed to be an infelicitous way of providing that the lender should be subrogated to the same rights of preferential payment as the relevant sections of the Indian Companies Act prescribe for labourers and workmen, and there is no reason to doubt the correctness of the conclusion to which the High Court has upon that basis come, that in a debenture holders' action as in a winding up of the Company this preferential right is limited to the property subject to a floating charge. But, as already pointed out, this is not the real question for decision. It is the earlier part of the agreement which became operative and the question is what is the right of the lender to whom the receiver has agreed to "hypothecate sufficient property worth at least Rs.60,000". To this question there can be only one answer. The lender is entitled to a charge in priority to the debenture holders. It has been urged that the order does not expressly authorise the creation of a prior charge. That is true, but such priority is implicitly authorised. For if it were not so the order would be stultified and the property could not be saved. It has been further urged that there was not in fact any hypothecation. This also appears to be true. But it cannot help the debenture holders: against them an agreement to hypothecate is as effectual as an actual hypothecation. This is the construction to which the Subordinate Judge came and in their Lordships' opinion he was right. The decrees under review in this appeal were made not in the debenture holders' suit, to which reference has been made, but in a fresh suit which the appellant commenced upon the directions given by the Subordinate Judge on his application to have his rights determined in that suit. All proper parties appear to have been before the Court and the result is the same.

Their Lordships are of opinion that the order of the High Court should be set aside and the order of the Subordinate Judge restored and that the respondents should pay the appellant his costs of these appeals and of the appeal to the High Court and will humbly advise His Majesty accordingly.

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[DELIVERED BY LORD SIMONDS]

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