APPELLATE CIVIL—FULL BENCH.

Before Sir Lionel Leach, Chief Justice, Mr. Justice Wadsworth and Mr. Justice Patanjali Sastri.

1939, November 15.

P. R. S. A. R. PERIAKARUPPAN CHETTIAR (PETITIONER), PETITIONER,

v.

P. S. A. R. A. R. ARUNACHALAM CHETTIAR BY AGENT SIVARAMAN CHETTIAR AND THREE OTHERS (NIL, RESPONDENTS AND NIL), RESPONDENTS.*

Provincial Insolvency Act (V of 1920), ss. 35 and 37—Adjudication order passed on the ground of fraudulent preference—Decision by Court later that there was no fraudulent preference—Adjudication, if can be annulled under sec. 35 of the Act—Failure of debtor to object to the order of adjudication—Whether bar to application for annulment—Disposal of assets on annulment—Power of Court under sec. 37.

On a creditor's petition an order of adjudication was passed on the ground that the debtors had executed a mortgage by way of fraudulent preference. The debtors did not appear and oppose. On a subsequent application by the petitioning creditor to set aside the said mortgage under section 54 of the Provincial Insolvency Act, it was finally decided that there was no act of fraudulent preference. The insolvents thereupon filed an application for the annulment of the adjudication. The Subordinate Judge annulled the same, but the District Judge reversed the order. On revision,

(i) *held* that the Court was bound to annul the adjudication under section 35 of the Provincial Insolvency Act. When an adjudication has taken place under the Provincial Insolvency Act and it has been shown that no act of insolvency has been committed, the Court has no discretion in the matter. It must annul the adjudication. The fact that a debtor does not object to an order of adjudication being passed against him is no bar

* Civil Revision Petitions Nos. 572, 573, 720 721 1005 and 1006 of 1936.

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to the granting of an application for an order setting aside the adjudication under the provisions of section 35.

Gopu China Jogayya v. *Satyanarayana*(1) disapproved.

After the above order of adjudication was passed but before it was annulled, the insolvents paid Rs. 3,600 to *P*, one of the creditors. On an application by the Official Receiver, *P* was directed to refund the money to the Official Receiver, which he did. After the order of adjudication was annulled, *P* asked the Court to direct that the money should be paid back to him.

(ii) *Held* that it would be improper to direct the Official Receiver to pay the money to *P* or to the insolvents as they were parties to a gross fraud on the Court and the fellow-creditors of *P*; and that the money should be vested in the Official Receiver, not as Official Receiver, but as a person appointed by the Court under section 37 of the Act, and that he should take steps to distribute the money rateably amongst the creditors who had proved in the insolvency proceedings.

Veerayya v. *Sreenivasa Rao*(2) followed.

PETITIONS under section 75 of Act V of 1920, praying the High Court to revise the decree of the District Court of Coimbatore in (i) Civil Miscellaneous Appeal No. 126 of 1935 preferred against the order of the Court of the Principal Subordinate Judge of Coimbatore, dated 30th March 1935 and made in Interlocutory Application No. 343 of 1935 in Insolvency Petition No. 242 of 1927; (ii) Civil Miscellaneous Appeal No. 134 of 1935 preferred against the order of the Court of the Principal Subordinate Judge of Coimbatore, dated 15th July 1935 and made in Interlocutory Application No. 283 of 1935 in Insolvency Petition Nos. 242 and 258 of 1927; (iii) Civil Miscellaneous Appeal No. 127 of 1935 preferred against the order of the Court of the Principal Subordinate Judge of Coimbatore, dated 30th March 1935 and made in Interlocutory

(1) (1939) 2 M.L.J. 753. (2) (1935) I.L.R. 58 Mad. 908 (F.B.).

Application No. 334 of 1935 in Insolvency Petition No. 258 of 1927; (iv) Civil Miscellaneous Appeal No. 140 of 1935 preferred against the order of the Court of the Principal Subordinate Judge of Coimbatore, dated 15th July 1935 and made in Interlocutory Application No. 402 of 1935 in Insolvency Petition No. 242 of 1927 and (v) Civil Miscellaneous Appeal No. 141 of 1935 preferred against the order of the Court of the Principal Subordinate Judge of Coimbatore, dated 15th July 1935 and made in Interlocutory Application No. 403 of 1935 in Insolvency Petition No. 258 of 1927.

K. Rajah Ayyar for *M. Krishna Bharati* for petitioner.—The ground on which Palani Goundan and his son were adjudicated as insolvents is that they have executed a mortgage by way of fraudulent preference. The Courts later on found that there was no fraudulent preference. As the ground of insolvency ceases to exist the Subordinate Judge was right in annulling the adjudication. Section 35 of the Provincial Insolvency Act does not put any restriction on the power of the Court to annul the adjudication. If it is established that the order of adjudication ought not to have been passed it must be set aside. The order of the District Judge reversing the decision of the Subordinate Judge is wrong on the plain construction of the section. He adopts the interpretation that for annulling an adjudication it must be shown that at the time when the adjudication order was first made it ought not to have been passed on the materials available then. There is no warrant for such construction. It is opposed to all principles of justice. When the alleged act of insolvency disappears even at a later stage the adjudication order must be annulled. [Baldwin on Insolvency, Ninth Edition, page 168, and Halsbury's Laws of England (Hailsham Edition), Vol. II, page 127, were referred to.]

[*In re Hester. Ex parte Hester*(1). *Ex parte Learoyd. In re Foulds*(2). *Ex parte Geisel. In re Stanger*(3). *Jagmohan*

(1) (1889) 22 Q.B.D. 632. 638. (2) (1878) 10 Ch.D. 3, 8.
(3) (1882) 22 Ch. D. 436.

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Narain v. *Grish Babu*(1) and *Karuthan Chettiar* v. *Raman Chetty*(2) were also referred to.]

The fact that a debtor did not object to the order of adjudication when it was passed is not a bar to annul it later; *Re Helsby*(3). The word used in section 35 of the Provincial Insolvency Act is "shall." So the Court is bound to set aside the adjudication order when the ground of insolvency ceases. In the corresponding section 21 of the Presidency Towns Insolvency Act the word used is "may." The Court has no discretion in the matter under section 35 of the Provincial Insolvency Act. The Courts found that there was no fraudulent preference. That decision is binding on the insolvent, the creditors and the mortgagee. As there is no act of insolvency the Court is bound to annul the adjudication. So the order of the District Judge is illegal.

Since the order of adjudication is annulled the money that was directed to be paid to the Official Receiver by Periakaruppan Chettiar, a creditor, must be returned to the creditor. [Sections 35, 37 and 43 of the Provincial Insolvency Act were referred to.] A debtor is entitled to prefer any creditor and his act cannot be questioned except in insolvency proceedings. Now that the insolvency is annulled the creditor Periakaruppan Chettiar is entitled to get back the money Rs. 3,600 which was paid to him by the insolvent. The other assets in the hands of the Official Receiver should be directed to be handed over to the debtors, since the insolvency has been annulled. There is no allegation of fraud regarding these other assets.

T. M. Krishnaswamy Ayyar, *N. Sivaramakrishna Ayyar*, *A. C. Sampath Iyengar*, *K. Kuttikrishna Menon* and *S. Ramaswami Ayyar* for respondents.—At the time when the adjudication order was passed there was fraudulent preference. No doubt at a later stage it was found that there was no fraudulent preference. But that cannot be a ground for annulling the adjudication. Unless it is found that at the time when the adjudication order was passed there was no fraudulent preference, under section 35 of the Provincial Insolvency Act, the Court cannot annul the adjudication order. The fact that the ground for adjudication ceases to exist at

(1) (1920) I.L.R. 42 All. 515. (2) (1926) 24 L.W. 486.
(3) (1893) 69 L.T. 864.

a later stage cannot be considered. If the facts, when the adjudication order was first passed, justify the passing of that order and the ground of insolvency existed then, it cannot be annulled.

[LEACH C.J.—You want to read something into section 35 of the Provincial Insolvency Act which is not there.]

[*Ex parte French*; *Re Trim*(1) and *Gopu China Jogayya* v. *Satyanarayana*(2) were referred to.]

When an adjudication order is passed it is binding only on the petitioning creditor and the insolvent: it is not a judgment *in rem*; *Official Assignee of Madras* v. *O. R. M. O. R. S. Firm*(3).

If your Lordships are not with me, the adjudication order goes. What then should be the consequential orders? A sum of Rs. 3,600 was paid by the insolvent to Periakaruppan Chettiar, a creditor, after the order of adjudication but before its annulment. The insolvents and the creditor were parties to a gross fraud. He should not be allowed to enjoy the fruits of that fraud. Justice requires that this sum of Rs. 3,600 should be distributed amongst all the creditors. Under section 37 (1) of the Provincial Insolvency Act the Court has got power to appoint a receiver and to vest the property in him; See *Veerayya* v. *Sreenivasa Rao*(4).

The other assets of the insolvent debtors also should be distributed amongst the creditors.

LEACH C.J.

The JUDGMENT of the Court was delivered by LEACH C.J.—These six civil revision petitions deal with three different matters arising out of the adjudication in insolvency of one Palani Goundan and his son Kandaswami Goundan by the Subordinate Judge of Coimbatore, but they may all be conveniently dealt with in one judgment. The order of adjudication was passed on 26th September 1928 on a petition filed by P. S. A. R. A. R. Arunachalam Chettiar, who alleged that the insolvents had fraudulently preferred

(1) (1882) 47 L.T. 339. (2) (1939) 2 M.L.J. 753.
(3) (1926) I.L.R. 50 Mad. 541. (4) (1935) I.L.R. 58 Mad. 908 (F.B.).

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another Chettiar, Somasundaram by name, by executing in his favour on 2nd June 1927 a mortgage of immovable property. The insolvents did not enter an appearance and the order of adjudication was passed without opposition. On 14th October 1929 the petitioning creditor applied to the Court for an order, under the provisions of section 54 of the Provincial Insolvency Act, setting aside the mortgage in favour of Somasundaram. The Subordinate Judge held that the fraudulent preference alleged had been established and set aside the transaction. An appeal followed to the District Judge of Coimbatore, who allowed it. The petitioning creditor then asked this Court to restore the order of the Subordinate Judge in the exercise of its revisional powers. This Court, however, agreed with the District Judge that there was no fraudulent preference and consequently refused to interfere with his order. On 25th March 1935, as the result of this Court's decision the insolvents applied to the Subordinate Judge for the annulment of the adjudication and a similar application was filed by a creditor, P. R. S. A. R. Periakaruppan Chettiar. These petitions were allowed and the adjudication was set aside under the provisions of section 35 of the Act. On appeal the District Judge reversed this decision and three of the petitions now before the Court, namely, Nos. 572, 720 and 721, ask this Court to revise the Judge's order.

Section 35 of the Provincial Insolvency Act says that where in the opinion of the Court a debtor ought not to have been adjudged insolvent, the Court shall, on the application of the debtor, or of any other person interested, by order in writing, annul the adjudication. The Subordinate Judge held that the Court had an unrestricted power to set aside the adjudication where

it was established that the order of adjudication ought not to have been passed. The District Judge considered that the power of the Court was restricted to a case where it could be shown that on the materials before it at the time of the adjudication the order ought not to have been passed. Although at a later stage it becomes apparent that the order of adjudication would not have been passed if the Court had been in possession of the whole of the facts the Court has, in the opinion of the District Judge, no power to set aside the adjudication.

The section contains no restriction on the power of the Court to set aside the adjudication where it is shown that the debtor ought not to have been adjudged insolvent. The District Judge has read something in the section which is not there and moreover his decision is opposed to principle. In the words of JAMES L.J. in *Ex parte Learoyd. In re Foulds*(1),

> "a man cannot be 'duly' adjudged a bankrupt unless the great requisite of all exists, that he has committed an act of bankruptcy. That is the capital offence of which he must have been guilty before he can be 'duly' adjudged a bankrupt."

If no act of insolvency has been committed the estate cannot be administered under the provisions of the Provincial Insolvency Act and section 35 has been inserted in the Act to give the Court power to set aside an adjudication which ought not to have been made. Section 35 of the Provincial Insolvency Act corresponds to section 35 of the Bankruptcy Act of 1883. *In re Hester. Ex parte Hester*(2), a case which was decided under the Bankruptcy Act of 1883, CHARLES J. said:

> "Is it a case in which, if he had been adjudged bankrupt, the Court would say that he ought not to have been so

(1) (1878) 10 Ch.D. 3. (2) (1889) 22 Q.B.D. 632.

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adjudged? These words are undoubtedly very wide, and many grounds can be conceived upon which the Court might come to the conclusion that a debtor ought not to have been adjudged bankrupt. For example, if there was no sufficient petitioning creditor's debt, or no act of bankruptcy, or if it turned out that the adjudication had been obtained for some sinister purpose, that is, some purpose foreign to the administration of bankruptcy law; all these are grounds on which the Court might be of opinion that the debtor ought not to have been adjudged bankrupt."

There is here express authority for the statement that where it is shown that no act of insolvency has in fact been committed the Court can set the adjudication aside on the ground that the debtor "ought not to have been adjudged insolvent."

In the Bankruptcy Act of 1869 which remained in force until the Bankruptcy Act of 1883 was passed there was no corresponding section to section 35, but the Court of Appeal held that in a proper case the Court had power to annul an adjudication; see *Ex parte Geisel. In re Stanger*(1). In that case the petitioning creditor alleged that his debtor had committed an act of bankruptcy by departing from his dwelling house with intent to defeat and delay his creditors. He had failed to show that the debtor was alive in some other place at the time. An order of adjudication was passed, but it was set aside by the Court of Appeal on the ground that the Court was not satisfied that the man was alive at the time. Probate had in fact been granted of the alleged bankrupt's will.

The fact that a debtor does not object to an order of adjudication being passed against him is no bar to the granting of an application for an order setting aside the adjudication under the provisions of section 35. In *Re Helsby*(2) a married woman was

(1) (1882) 22 Ch. D. 436.

(2) (1893) 69 L.T. 864.

adjudged bankrupt on the ground that she was carrying on a business of her own with her own capital. She offered no opposition when the adjudication was made and she allowed it to stand until criminal proceedings for alleged offences against the bankruptcy law had been instituted against her and other members of her family. She then applied to have the adjudication set aside and it was held by the Divisional Court that she was entitled to the order asked for because it had become apparent that she was not carrying on a business of her own with her own capital.

In support of his contention that the order of the District Judge is right Mr. T. M. Krishnaswami Ayyar has quoted to us two cases, *Ex parte French*; *Re Trim*(1) and *Gopu China Jogayya* v. *Satyanarayana* (2). In the first of these cases, a trader having committed an act of bankruptcy, a petition was presented against him by two creditors and an adjudication followed. Subsequently, the debtor moved the Court to annul the adjudication on the ground of the insufficiency of the petitioning creditors' debts. BACON C.J. held that the debtor ought to have appealed against the order of adjudication within the twenty-one days limited for that purpose, and that not having done so, the publication in the Gazette was, under section 10 of the Bankruptcy Act, 1869, conclusive evidence of the validity of the adjudication. The fact that the petitioning creditors' debt was not of the amount on which a petition could be based was not a sufficient reason for the annulment of the adjudication. The judgment in this case was delivered on 13th November 1882, four days before the judgment of the Court of Appeal in *Ex parte Geisel. In re Stanger* (3) where it was held that section 10 of the Bankruptcy

(1) (1882) 47 L.T. 339. (2) (1939) 2 M.L.J. 753. (1)
(3) (1882) 22 Ch.D. 436.

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Act, 1869, had no application and an adjudication could be annulled even after the time for appealing had elapsed. Therefore *Ex parte French*; *Re Trim*(1) must be taken to have been overruled. It certainly has no application in the case before us.

In *Gopu China Jogayya* v. *Satyanarayana*(2) a creditor applied to have an order of adjudication annulled on the ground that the petitioning creditor's debt was a bogus one. KUNHI RAMAN J. said that there was no doubt that but for the petition the adjudication would not have taken place but he added:

> "Once an adjudication takes place all the other creditors of the debtor become interested in the matter and unless the appellant here is able to show that the debtor did not owe any other debts or that the debtor was not really insolvent at the time of the order of adjudication by the lower Court, it is not open to him to contend that it is a case in which the order of adjudication ought not to have been made."

These observations cannot be accepted as a correct statement of the law. When an adjudication has taken place under the Provincial Insolvency Act and it has been shown that no act of insolvency has been committed the Court has no discretion in the matter. It must annul the adjudication. The word used is "shall" and the section in this respect differs from section 21 of the Presidency Towns Insolvency Act where the word "may" is used.

In the present case the judgment of this Court upholding the decision of the District Judge that there was no fraudulent preference is conclusive on the question whether an act of insolvency had taken place. The decision was that there had been no fraudulent preference and this decision is binding on all, the insolvents, the creditors and the mortgagee. As there was no act of insolvency the Court is bound to annul the

(1) (1882) 47 L.T. 339. (2) (1939) 2 M.L.J. 753.

adjudication. Therefore the order of the District Judge will be discharged and the order of the Subordinate Judge restored with costs in favour of the petitioners in Petitions Nos. 572, 720 and 721 of 1936 (one set throughout). The costs will be paid by the petitioning creditor.

Civil Revision Petition No. 573 of 1936 arises out of an application filed by the Official Receiver in these circumstances. After the adjudication but before its annulment, the insolvent paid to P. R. S. A. R. Periakaruppan Chettiar a total sum of Rs. 3,600. There were five payments altogether and they were made between 9th September 1928 and 22nd September 1931. There is no doubt here that the insolvents and Periakaruppan Chettiar were parties to a gross fraud. The Official Receiver applied to the Court to direct Periakaruppan Chettiar to refund a sum of Rs. 2,700 which the Official Receiver understood was the total amount which had been paid by the insolvents to this creditor. The Subordinate Judge held that the creditor had received only Rs. 1,200 during the period of adjudication, but as the order of adjudication had been annulled he dismissed the Official Receiver's petition. An appeal followed to the District Judge, who held that Periakaruppan Chettiar had in fact received Rs. 3,600 and directed him to pay it over to the Official Receiver, which he did. It is common ground that the total amount received by Periakaruppan Chettiar was the Rs. 3,600 found by the District Judge. Periakaruppan Chettiar now asks this Court to revise the order of the District Judge and direct that the money be paid over to him. Section 37 (1) of the Provincial Insolvency Act reads as follows :—

"Where an adjudication is annulled, all sales and dispositions of property and payments duly made, and all acts

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therto fore done, by the Court or receiver shall be valid, but subject as aforesaid, the property of the debtor who was adjudged insolvent shall vest in such person as the Court may appoint or in default of any such appointment, shall revert to the debtor to the extent of his interest therein on such conditions (if any) as the Court may, by order in writing, declare."

In *Veerayya* v. *Sreenivasa Rao*(1) a Full Bench of this Court held that under this section the Insolvency Court retains full power to give directions as to the realization and disposal of the debtor's assets. The power ought not to be used arbitrarily but used in the interests of the general body of creditors, which meant that the proper order for the Court to pass was that the appointee should continue to realize and distribute the debtor's property in accordance with the provisions of the Act. The person appointed had not all the statutory powers of an Official Receiver but only such powers as the Court conferred upon him.

Section 37 gives the Court a wide discretion. The annulment of the adjudication does not mean that the debtor who is adjudicated is necessarily to be placed in possession of the property which is in the hands of the Official Receiver at the time the adjudication is set aside. The directions of the Court must depend on the circumstances in each case. In this case it would not be proper to allow Periakaruppan Chettiar, who has been guilty of a gross fraud on the Court and on his fellow creditors, to enjoy the fruits of his fraud. When the money was in his hands it was not his. It was money which was vested in the Official Receiver and he only got possession of it as the result of the fraud. When the adjudication was set aside the Official Receiver was not as such entitled to the money. It then belonged to the insolvents, as Mr. Rajah Iyer

(1) (1935) I.L.R. 58 Mad. 908 (F.B.).

concedes. The money is now in the hands of the Official Receiver and is still the property of the debtors. In view of their participation in the fraud we consider that it would also be improper to direct the Official Receiver to pay it over to them. We are of the opinion that the proper course in the circumstances of this case is to direct that the money be vested in the Official Receiver, not as Official Receiver, but as a person appointed by the Court under the section, and we direct accordingly. The Official Receiver will in due course take steps to distribute the Rs. 3,600 rateably amongst the creditors who have proved in the insolvency proceedings. He will be entitled to the usual commission and charges. This petition has been opposed by the petitioning creditor and the Official Receiver. They are entitled to their costs (one set throughout).

The remaining petitions are Nos. 1005 and 1006. The petitioning creditor here asks that certain other assets in the hands of the Official Receiver should be distributed by him amongst the creditors. There are no special circumstances which justify an order of this nature. The Official Receiver will be directed to deliver the assets, other than the Rs. 3,600, to the debtors two months hence. The properties will be handed over to them then, subject, of course, to any order of the Court which may be passed in the meantime. There will be no order as to costs in these petitions.

The Official Receiver will be allowed one set of costs out of the estate throughout in respect of petitions Nos. 572, 720 and 721, and one set in petitions Nos. 1005 and 1006.

V.V.C.