Supreme Court of India
B.O.I. Finance Ltd vs The Custodian & Ors on 19 March, 1997
Author: Kirpal
Bench: Cji, S.P. Bharucha, B.N. Kirpal

PETITIONER:
B.O.I. FINANCE LTD.

Vs.

RESPONDENT:
THE CUSTODIAN & ORS.

DATE OF JUDGMENT: 19/03/1997

BENCH:
CJI, S.P. BHARUCHA, B.N. KIRPAL

ACT:

HEADNOTE:

JUDGMENT:

[With C.A. Nos. 3656-57/95, 4863-64/94, 4390/94, 3529- 3530/95, 5546/94 3165/95, 3172/95, 3760/95, 3658-3659895, 8411/94, 8411/94, 10284/95, 10260/95 , 6545/95. C.A. 2104/97 @ S.L.P (C) No. 54258/95 with J U D G M E N T KIRPAL, J.

These appeals, under Section 10 of the Special Court (Trial) of Offences relating to Transactions in Securities) Act, 1992 (hereinafter referred to as 'The Special Court Act') arise from the judgment of the Special Court at Bombay which decided common questions of law relating certain transactions of purchase of securities by the appellant banks from some of the brokers of whom the Special Court's Act, 1992 had been made applicable.

The appellant banks had prior to 6th June, 1992, entered into contracts with different brokers for the purchase and sale of certain securities which were not listed on any stock exchange. For the purpose of this case these contracts have been regarded as ready-forward transactions or buy-back transactions. The parties are agreed, and it is on this basis that the High Court also proceeded. That the nature of such a transaction is that it consists of two inter-connected legs, namely, the first or the ready leg, consisting of purchase or sale of certain securities at a specified price, and the second or froward leg, consisting of the sale or purchase of the same of similar securities at a letter date at a price determined on the first date. Such ready-forward transactions have, in most cases, been

entered into either by execution of a single document or by execution of two documents contemporaneously, one representing the first or ready leg and the other the forward or second leg. On such contacts being entered into the ready leg of the transactions were completed with the appellants paying the agreed price and receiving the delivery of the securities which were agreed to the purchased.

Before the forward leg of the transactions could be completed, a Special court (Trial of Offences relating a transactions in securities) Ordinance 1992 was issued on 6.6.1992 which was subsequently replaced by the Act. Special Courts Act. 1992 :

The necessity for issuance of the said Ordinance is contained in the statement of objects and reasons which reads as follows :

"In the course of the investigations by the Reserve Bank of India, large scale irregularities and malpractices were noticed in transactions in both the Government and other securities, indulged in the some brokers in collusion with the employees of various banks and Financial institutions. The said irregularities and malpractices led to the diversion of funds from banks and financial institutions to the individual accounts of certain brokers.

2. To deal with the situation and in particular to ensure the speedy recovery of the huge amount involved to punish the guilty and restore confidence in and maintain the basic integrity and credibility of the banks and financial institutions the Special Court (Trial of Offences Relating to Transactions in Securities) Ordinance. 1992 was promulgated on the 6th June 1992. The Ordinance provides for the establishment of a Special Court with a sitting judge of a High Court for speedy trial of offences relating t transactions in securities and disposal of properties attached. It also provides for appointment of one of more Custodians for attaching the property of the offenders for attaching the property of the offenders with a view to prevent diversion of such properties by the offenders."

We will refer to some of the provisions of the said Act which are relevant for the purpose of this matter.

Section 2 contains definition. Th term "securities" is defined in Section 2(c) and is as follows:-

> "" securities includes-
>
> (i) shares, scrips, stocks, bonds, debentures, debenture stock, units of the Unit Trust of India or any other mutual fund or other marketable securities of a like nature in or of any incorporated company or other body corporate;
>
> (ii) Government Securities: and
>
> (iii) rights or interest in securities."

Section 3 of the said act relates to appointment and functions of custodian and reds as follow: "3(1) The Central Government may appoint one or more Custodians as it may deem fir for the purpose of this Act.

(2) The Custodian may, on being satisfied on information received that any person has been involved in any offence relating to transaction in securities after the Ist day of April, 1991 and on the before the 6th June, 1992, notify the name of such person in the Official Gazette.

(3) Notwithstanding anything contained in the Code and any other law for the time being in force, on and form the date of notification under sub-section (2), any property, movable or immovable, or both belonging to any person notified under that sub-section shall stand attached simultaneously with the issue of the notification. (4) The property attached under sub-section (3) shall be dealt with by the Custodian in such manner as the Special Court may direct.

(5) The custodian, may take assistance of any person which exercising his powers or for discharging his duties under this section and Section 4."

The Custodian has been given power under Section 4 to order the cancellation of any contract or agreement entered into between 1.4.1991 and 6.6.1992 which, in his opinion, has been entered into fraudulently or to defeat the provisions of the Act. On such cancellation being ordered, the property stands attached under the Act.

Special Court is established under Section 5 by the Central Government issuing the notification to the effect. Section 11 deals with the discharge of liabilities and reads as follows:

"11(1) Notwithstanding anything contained in the Code and any other law for the time being in force, the Special Court may make such order as it may deem fit directing the order as it may deem fir directing the Custodian for the disposal of the property under attachment.

(2) The following liabilities shall be paid or discharged in full, as far as may be, in the order as under :-

(a) all revenues, taxes, cesses and rates due from the persons notified by the Custodian under sub-section 92) of Section 3 to the Central Government or any State Government or any local authority;

(b) all amounts due from the person so notified by the Custodian to any bank or financial institution or mutual fund:

(c) any other liability as may be specified by the Special Court from time to time."

Section 13 provides that the provisions of the Act will have an overriding effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law, other than this Act, or in any decree or order of any Court Tribunal or other authority.

As is evident from the above the intention of framing the aforesaid Act was to protect the interest of the banks and financial institutions from irregularities and mal- practices which had been committed by some brokers in collusion with employees of various banks and financial institutions. The important feature of the Act was the attachment of the properties of the offenders with a view toe prevent its diversion. The special Court is required to pass orders directing the disposal of the properties under Attachment. Sub-section (2) of Section 11 provides for the priorities in which the liabilities of the notified person are to be discharged from out of the attached properties. Considering that the act has been passed because of the diversion of funds from the banks and financial institutions to individual accounts of certain brokers, the implication of Section 11(2)(3) clearly is that after the discharge of the liabilities under Section 11(2)(a), the amounts which are paid to the banks would probably be those funds which were diverted from the banks by reason of mal-practices in the security transactions. In other words, the losses cause to the banks and the financial institutions were to be made from out of the assets of the notified persons.

At this stage, it will be relevant to see as to what is the position of the Custodian.

Section 4 of the Act gives the custodian the power to cancel such contracts or agreements which have been entered into fraudulently. That apart, he is merely a custodian of the properties of the notified persons which stand attached under the Act and such properties are to be dealt with by him such manner as the Special Court may direct.

The Act shows that the Custodian has three main function to perform. Firstly; he has the authority to notify a person under Section 3(2) who has been involved in any offence relating to transactions in securities during the period 1.4.1991 to 6.6.1992. Secondly; he has been given the authority by Section 4 to cancel contracts or agreements relating to the properties of the notified persons which, in his opinion, have been entered into fraudulently or for the purpose of defeating the provisions of the Act. Lastly; he is required to deal with properties in the manner as directed by the Special Court. To put it simply the Custodian is required to assist in the attachment of notified person's property and to manage the same thereafter. The properties of the notified persons, whether attached or not, do not at any point of time, vest in him. He is merely a Custodian and his position is not like that of a Receiver under Civil Procedure Code (Section 94 Order

44) or an official receiver under Provincial Insolvency Act or official assignee under Presidency Insolvency Act. There is no vesting of the attached properties of the notified persons in the custodian. This is contract with Section 28(2) of the Provincial Insolvency Act and Section 17 of the Presidency Insolvency Act. There is vesting in the official receiver of official assignee. He is also not in a position of a an official liquidator under the Companies Act in whom not only the property vests but who is also in control thereof. This being so there is considerable force i the contention of the counsel for the appellants that, except for the power exercisable under Section 4, the position of the

Custodian the same as that of the notified person himself.

Pursuant to the promulgation of the Ordinance in 1992. Mr. Justice Variava of the Bombay High Court has been constituted as a Special Court at Bombay. this court has been hearing several matters brought before it by the Custodian as well as other parties.

INITIATION OF PROCEEDINGS AND DECISION OF THE SPECIAL COURT The custodian filed applications before the Special Court to the effect that the above mentioned contracts entered into between the banks and the notified person were void. It was contended that such ready-forward transactions were illegal under the provisions of the Banking Regulation act 1949 and the Securities Regulation Act 1956. It was therefore, contended that as the contracts were void those securities which had been sold to the appellants in the ready leg continued to be, in law, the properties of the notified persons on the date they were so notified and the same stood attached under Section 3(3) of the Act. The applications required the Special Court to direct the appellant banks to return the said securities. Similar applications were also filed, subsequently, by Sh. Harshad Mehta, one of the notified parties, with whom such transactions had been entered into by some other appellant banks.

Resisting the applications the appellant banks had, inter alia. contended that the transactions in question were no illegal and did not contravene the provisions of Banking Regulation Act, 1949 and the circulars issued by the Reserve Bank of India thereunder and not were they contrary to the provisions of the Securities Contract Regulation Act, 1956 and the notification issued under Section 16 thereof. It was further contended that in any case the contracts in question were severable and the illegality, if any, was attached only to the second leg and not to the first let. The transfer of tile had taken place in favour of the appellant banks and the securities did not belong to the notified persons and as such they could not be regarded as being attached under Section 3 (3) of the Act. It was also submitted that, assuming that the entire contract was illegal and void, neither the Custodian nor the notified parties could ask for the relief sought for as both the parties to the contract were in pari delicto. It was also contended that in the event the court was to order the return of the securities when the notified parties should be directed to return the consideration received by them.

The Special Court heard the applications only on the points of law without going into the facts of any case. The case proceeded on the assumption that the appellants had entered into ready forward transactions it was accepted by the parties before the Special Court that the ready-forward transaction (or as sometimes described as a buy-back transaction) had four ingredients; (i) there must be a present sale or purchase with the commitment to repurchase or resale in further; (ii) the contract must be between the same parties; (iii) it must be between of some kind of securities and for the same quantum of securities and; (iv) the transaction must be entered into on the same day or contemporaneously and the price of resale and repurchase would be fixed at the state of first leg itself.

The Special Court by a common judgment proceeded to decide the general questions of law which arose by regarding the transactions in question to be ready-forward transactions. It took not of the concession on behalf of the counsel for the Custodian that if a transfer had already taken place prior

to the date of the notification then the concerned property could not be properly regarded as belonging to the notified persons and would not stand attached. It allowed the applications of the respondents holding that the circulars issued under the Banking Act were binding and, since the transactions were contrary thereto, the same were illegal and void in respect of the third parties. It rejected the contention that the contract was severable and that the first leg was not hit by the illegality. It further came to the conclusion that the contracts were also illegal under the provisions of the Securities Regulation Act, 1956 and the notification issued under Section 16 thereof. It also came to the conclusion that the principles of 'in pari delicto' did not come into play in present case as the Custodian was not making any claim in the applications but was merely bringing to the attention of the court the fact that third parties were in possession of properties which stood attached under the provisions of Act of 1992. The fact that the Custodian had not exercised any power under Section 4 of the Special Courts Act, in respect of these transactions, was also taken note of .

Having come to the conclusion that the contracts were void, the Court held that the claim of the banks for restitution will have to be dealt with as an ordinary claim against the property of a notified person at the stage of distribution under Section 11. It accordingly directed the banks to return the securities to be Custodian. while giving this direction it further observed that if these securities had been transferred by the banks to third parties then no right could be created in their favour as the banks had no right to transfer them and, therefore, the banks should purchase the securities of the same value from the market and deliver the same to the custodian.

The appellant banks have challenged, in these appeals, the correctness of the aforesaid decision of the Special Court. The contentions raised before the Special Court were reiterated by the learned counsels for the appellant banks while Mr. Jethmalani on behalf of Harshad mehta supported the decision of the Special Court. The Solicitor General, appearing on behalf of Reserve Bank of India addressed arguments with regard to the effect of the circulars issued by the Reserve bank of India on the contracts in issue.

Having heard very lucid arguments of the learned counsels for the parties, we no propose to deal with these contentions which are necessary for deciding these appeals. RE: ALLEGED VIOLATION OF THE CIRCULARS ISSUED BY THE RESERVED BANK OF INDIA With regard to the finding of the Special Court that the transactions in question were illegal, as they were in contravention of the circulars which were issued by the Reserve Bank of India under the provision of The Act, it was contended by Mr. Cooper, learned counsel, that the circulars issued were no more than guidelines which were required to be followed by the Bank and they were not mandatory in nature. Elaborating this contention, Mr. Copper submitted that the Banking companies Act contains provision which enable the Reserve Bank of India issue directions which were mandatory and also give advice to the banks. Our attention was drawn to Sections 21 and 35A of the said Act and it was contended that the directions which are issued by the Reserve Bank of India under these two provisions are clearly mandatory. On the other hand, Section 36 (1)(a) & (1)(b) gives power to the Reserve Bank of India to give advice of lend assistance and any action taken thereunder cannot be regarded as mandatory. It was submitted that the language of the circulars dated 14.4.1987 and 1.12.1987, which prohibit the banks from entering into buying back arrangements, clearly shows that the said circulars were only

in the nature of advice and must be regarded as having been issued under Section 36(1)(a) and (1)(b) of the Act.

At this juncture, it will be appropriate to refer to the said circulars dated 15.4.1987 and 1.12.1987. The Circular dated 15.4.1987 was marked "confidential" and was issued to all scheduled commercial banks and dealt with the question of buy-back arrangement in Government and other approved securities entered into by commercial banks., The relevant portion of this circular reads thus:

> "Buy-back arrangements in government and other approved Securities entered into by commercial banks,

Please refer to paragraph 10(a) of Governor's letter No. CPC. BC.

84/279A-87 dated 31st March, 1987.

2. It has been observed that banks often enter into by back arrangements in respect of Government and other approved Securities among themselves and with their large public sector and corporate clients. The banks are advised respect of their by-back arrangements with banks and others.

> A. Prohibition against by-back arrangements in respect of Corporate Securities and Bond issued by Public Sector Undertakings.

Bank should not enter into by-back arrangement in respect of their holdings of public sector bonds of corporate shares and debentures.

B. By-back arrangements in Government and other Approved Securities with (non-bank) clients.

i) The buy back deals should be exclusively confined to Government and other Approved Securities and the re-purchase date should be fixed after a minimum period of 30 days from the date of sale of the securities in question.

ii) The purchase/sale pries under the arrangement should be in alignment with the proximate market rates prevalent on the date of the original transaction for the relevant Government and other Approved Securities.

iii) No sales of Government and other Approved Securities under the arrangement should be effected by banks unless the same are actually held by them on their own investment portfolio either in the form of actual scrips or in SGL account maintained with Reserve Bank.

iv) Immediately on sale, the corresponding amount should invariably be deducted from the investment account of the bank and its SLR assets for the entire period (minimum 30 days) of

holding by the purchaser/counter-party.

v) Interest on the securities at coupon rates would be paid by the banks after reduction of tax on the lines indicated in our circular No. DBOD.BP.PC 88/C.469 (81-B)-86 dated 14 August. 1986.

.....

4. A copy of this circular may please be placed before the Board of Directors for their information.

Under advice to us.

5. Please acknowledge receipt."

(Emphasis added) The letter of December 1. 1987 issued by the Reserve Bank of India was also addressed to all scheduled commercial banks and was as follow:

> "Buy-back arrangements in units of Unit Trust of India (UTI) We have received inquires from banks where they can enter into buy-back arrangement in units of UTI under 1964 Scheme. We have examined the matter and have to advise that the units are not approved security for buy-back arrangement in terms of the instructions contained i out circular DBOD. No. DIR. BC. 42/C.347-87 date 15th April,
>
> 2. Please acknowledge receipt."

(Emphasis added) Referring to the language used in the said circulars dated 15.4.1987 and 1.12.1987. It was contended by Mr. copper that the banks were mainly advised to follow the guidelines contained in the said letters and that the contents thereto were not binding on the banks.

Section 21 of the Banking Companies Act, and sub- section (2) in particular, entitles the Reserve Bank of India to give directions to the banking companies with regard to the matters specified in the said section. Sub- section (3) provides that every banking company shall be bound to comply with any directions given to it under the said Section. Section 35 A(i) also contains the power of the Reserve Bank of India to give directions and the same reads as under:

"35A(1) where the Reserve Bank is satisfied that-

(a) in the [public interest] or [(aa) in the interest of banking policy; or]

(b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors of in a manner prejudicial to the interests of the banking company : or

(c) to secure the proper management of any banking company generally;

It is necessary to issue directions to banking companies generally or to any banking company in particular it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions."

There can obviously be no doubt, as is evident from the plain reading of the said provisions, the directions issued under Sections 21 and 35A are binding on the banking companies. Section 36 (1)(a) and (b), on which reliance is placed, reads thus:

> "(1) The Reserve Bank may -
>
> (a) caution or prohibit banking companies generally or any banking company in particular against entering into any particular transaction or class or transactions and generally give advice to any banking company;

(b) on request by the companies concerned and subject to the provisions of [section 44 A] assist as intermediary or otherwise in proposal for the amalgamation of such banking companies." (Emphasis added) Referring to Section 36 (1)(a), we find that it empowers he Reserve Bank to "Caution or prohibit" the banking companies from entering into any particular type of transaction or generally to give advice to the said banking companies. This provision not only enables the Reserve Bank to assume an advisory role but it also gives it any power to prohibit a banking company against entering into any particular transaction/s or class of transaction. The use of words "caution or prohibit" in Section 36(1)(a) clearly implies that when the Reserve Bank of India Prohibits the Banking companies from entering into any particular transaction then the Reserve bank of India Prohibit the banking companies from entering into any particular transaction then such a direction which is issued would be binding on the banks and has to be complied with. While the Reserve Bank of India has the power, under Section 36 (1)(a) of the Act, to give advice or to caution the banking companies which may not be binding on the banking companies, but when the Reserve Bank prohibits the banking companies against their entering into any particular transaction or class of transactions, the said prohibition has to be regard as being binding. The power to prohibit, given by Section 36, will be meaningless if it was not mean to be binding on the baking companies.

It is no doubt true that the circular dated 15.4.1987 states that the banks are "advised" to follow the guidelines given thereunder, but paragraph 2A of the said Circular clearly contains the prohibition relating to the buy-back arrangements. Similarly, under paragraph 28, which is applicable in the present case, by use of the words "should be" the circular clearly implies that the direction contained thereunder is meant to be binding. The word "advised" used in paragraph 2 of the first circular cannot be read in isolation. Reading the said circular, as a whole, it can leave no doubt in any one's mind that what was stated in the said document was meant to be binding on the banking companies and, was not merely an 'advice' or a 'caution' which could be ignored.

It was then submitted that even if it is held that the said circulars were binding they could only bind the banks and not the third parties. The submission was that by contravening the direction contained in the said circulars, the contracts which were entered into between the banks and the

third parties could no be invalidated and the only result of such contravention would be the levy of penalty under Section 46 of the said Act.

It is not in dispute that the said circulars which have been issued were not made public. The said circulars were confidential documents and required the banking companies to transact their businesses in a particular manner namely they should not enter into any buy-back contracts which were not according to the terms of the circulars. The Act itself does not provide that, where the directions issued by the confidential circulars are violated by the bank, the contracts entered into with the third parties would in any way be invalidated. The said circulars also, did not say that the consequence of the directions contained therein not being followed by the Banking Companies will result in such transaction being regarded as void. Indeed, no such stipulation could be made which would adversely affect third parties to whom no direction have been or could be issued and who were not aware of such directions issued to the banks.

It will be appropriate at this stage, to consider the decision of this Court in the cause of SETH BANARASI DAS. VS. THE CANE COMMISSIONER & ANOTHER, 1963 SCR (Supp.) 760. In that case an agreement was entered into between the appellant and the cane marketing society for supply of sugar cane. The appellant claimed that there was short supply or sugar cane and the society moved that Cane commissioner for arbitration. These proceedings were sought to be challenged by the appellant by contending that the Cane Commissioner and no right to assume the office arbitrator in this dispute because no valid agreement had been entered into between the parties, as contemplated by Section 18(2) of the Uttar Pradesh Sugar Factories Control Act, 1938 and in the form XII as prescribed under the rules made thereunder. It was also contended that there were some blanks which were left to be filled in the prescribed form and it also did not have the signature of any representative of the sugar mill. On behalf of the appellant it was contended in this Court that the Provision of Section 18(2) of Utter Pradesh Sugar Factories control Act were mandatory and had to be followed to the letter. Inasmuch as the Act and the Rules prescribed a penalty for breach of a the appellant may be guilty and could be punished but, it was submitted, the mandatory provision not having been followed no valid contract could come into existence and, consequently, the Cane Commissioner had no jurisdiction proceed in the matter for appointment of an arbitrator. While repelling the contention, this Court at page 780 observed as follows:

> "This rule has been applied in many cases both in India and in England. In State of U.P. V. Manbodhan Lal Srivastava, this Court observed that no general rule can be laid down but the object of the statute must be looked at and even if the provision the worded in a mandatory form, if its neglect would work serious general inconvenience of injustice to persons who have no control over those entrusted with the duty and at the same time would not promote the main object of the Legislature, it is to be treated only as directory and the neglect of it though punishable would not affect the validity of the acts done.
>
> These observation have been followed in other cases and recently in Bhikraj V. Union of India, it was observed that where a statute requires that a thing shall be done in a particular manner or form but does not itself set out the consequences of

> non-compliance the question whether the prescription of law shall be treated as mandatory or directory could only be solved by regarding the object, purpose and scope of that law. If the statute is fund to the directory a penalty may be incurred for non-compliance but the act or thing done is regarded as good. It is unnecessary to multiply these cases which are based upon the statement in Maxwell which is quoted over and over again."

It will also be useful to refer to the decision of the High Court of Australia in the case of Yango Pastoral Company Pvt. Limited and others Vs. First Chicago Australia Limited and other 1978, 139 C.L.R. 411 where mason, J. Made observations in this regard. That was a case where Section 8 of the Banking Act, 1959 prohibited a body corporate from carrying on the business of banking without a license. The question arose whether a mortgage and guarantees given to a unlicensed corporation in the course of carrying on business were void or unenforceable. The High Court unanimously held that nothing in the statute made them void and that the separate question of illegal performance should be determined by examining the terms of the statute to determine the impact of illegality on the enfoceability of the contract. At page 428, it was observed as follows;

> "The weighing of considerations of public policy in the case dn the decision in favour of enforcing the contract is influenced by the from of the particular legislation. In this case the Act, as I have mentioned, is to a large extent directed to aiding the Government in executing its fiscal policy rather than regulating the relationship between banker and customer per se, a feature which lends support for the view that the provision of a large recurrent penalty for offences against Section 8 is Parliament's determination of the consequences of breach of the section and as the only legal consequences thereof. There is much to be said for the view that once a statutory penalty has been provided for an offence the rule of the common law in determining the legal consequences of commission of the offence is thereby diminished-see may judgment in Jackson Vs. Harrison, (1978) 138 C.L.R. 438, at P. 452. See also the suggestions that the principle cannot apply to all statutory offences (Beresford Vs. Royal Insurance Co. Ltd. in the Court of Appeal (1937) 2 K.B. 197, at p 22, per Lord Wright ; Marles V. Philip Trant & Sons Ltd. (1954) 1 Q.B. 29, at p. 37, per Denning L.J, and that it would be a curious thing if the offender is to be punished twice, civilly as well as criminally (st. John Shipping Corporation Vs. Joseph Rank Ltd. (1957) 1 Q.B. 267, at p. 292, per Devlin J.). The main considerations from which the principle ex turpi causa arose can be seen in the reluctance of the courts to be instrumental in offering an inducement to crime or removing a restraint to crime: Beresford's Case (1938) A.C. at pp. 586; Amicable Society Vs. Bolland (1830) 4 Bligh (N.S) 194 at P. 211. However, in the present case Parliament has provided a penalty which is a measure of the deterrent which it intends to operate in respect of non-compliance with Section 8. In this case it is not for the court to hold that further consequences should flow, consequences which in financial terms could well far exceed the prescribed penalty and could even conceivably lead the plaintiff to insolvency with resultant loss to innocent landers or with resultant loss to innocent lenders or investors. In saying this I am mindful that there could be a case where the

> facts disclose that the plaintiff stands to gain by enforcement of rights gained through an illegal activity far more than the prescribed penalty. This circumstance might provide an sufficient foundation for attributing a different intention to the legislature. It may be that the true basis of the principle is that the court will refuse to enforce a transaction with a fraudulent or immoral purpose : Bereford Vs. Royal Insurance Co. Ltd. (1937) 2 K.B. 197 at p. 220.

On this basis the common law principle of ex turpi causa can be given and operation consistent with , through subordinate to, the statutory intention, dying relief in those cases where a plaintiff may otherwise evade the real consequences of a breach of statutory prohibition." (Emphasis added) The aforesadi principles will clearly be applicable in the present case as well. The non-compliance of the directions issued by the Reserve Bank may result in prosecution/or levy of penalty under section 46, but it cannot result in invalidation of any contract by the bank with the third party. If the contention of the Custodian is accepted it will result in invalidation of agreements by the banks, even where the third parties may not be aware of the direction which are being violated. To give an example if the Reserve Bank by confidential circulars fixes the limit in excess of which the banks cannot give any lone but, without informing the third party, the bank while exceeding it's limit gives a loan which is then utilised by the bank's customer. It will be inequitable and improper to hold hat as the directions of the Reserve Bank had not been complied with by the bank, the grant of loan cannot be regarded as valid and, as a consequence thereof, the customer must return the amount received even though he may have utilised the same in his business. Yet another instance may be where the bank advance loan by charging interest at a rate lower than the minimum which may have been fixed by the Reserve Bank, in a direction issued under Section 36 (1)(a). As far as the customer is concerned, it may not be aware of the direction fixing them minimum rate of interest. Can it be said, in such a case, that the advance of loan itself was illegal or that the bank would be entitled to received that higher rate of interest ? In our opinion it will be wholly unjust and inequitable to hold that such transactions entered into by the bank with a customer. which transactions are otherwise not invalid, can be regarded as void because the bank did not follow the directions or instructions issued by the Reserve Bank of India.

The instructions which were issued by the said circulars were meant to complied with by a banking companies only and did not purport to, nor could they, be binding on the third parties. This being so, even if the appellant banks had been prohibited from entering into the buy-back arrangement in question, that by itself, would not invalidate the contracts though the infringement of the said directions may lead to action being taken under Section 46 of the Act.

SUBMISSIONS OF THE PARTIES On 27.6.1969 the Government issued a Notification under Section 16(1) of the Securities Contracts (Regulations) Act, 1956 which is as follows :

> "S.O. 2561. in exercise of the powers conferred by sub-section (1) of Section 16 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) the Central Government being of opinion that it is necessary to prevent undesirable speculation in securities in the whole of India, hereby declares that no person in the territory to which the said Act extends, shall have which the permission of the Central Government enter into

> any contract for the sale or purchase of securities other than such sport delivery contract or contract for cash or hand delivery or special delivery in any securities as is permissible under the side Act and the rules, bye-laws and regulations of a recognised block exchange: Provided that contract other than a spot delivery contract or contract for cash or hand delivery or special delivery in any securities on the Cleared Securities List of a recognised stock exchange may be entered into between its members of through or with any such member for the purpose of closing out or liquidation all existing contracts entered into upto the date of this notification and remaining to the performed after the said date, but such contract shall be subject to recognised stock exchange that come into force when further new dealings are prohibited in any securities on the Cleared Securities List and subject also to such terms and conditions if any as the Central Government may form time to time impose."

As a result of the aforesaid Notification, except for sale of purchase of securities under a spot delivery contract or contract for cash or hand delivery or special delivery all other contracts were prohibited. As a consequence thereof entering into a forward transaction become illegal.

Proceeding on the assumption that the aforesaid notification applied to the securities in question even though they were not listed on the stock exchange, the counsel for the appellants submitted that each contract between the parties. Namely, the notifies person and that appellant was in two parts, According to this, the securities were sold by the notified person to the appellant and market price in respect thereof, was paid. The contract further stipulated that after a period of 14 days on a fixed day, at a fixed price the transaction will be reversed i.e. to say the appellant will sell back the securities, which had been purchased by it, to the notified person who would pay the price which was agreed to between the parties. Assuming the contract as notified date the securities had already been sold by the notified person to the appellant when the same were delivered to the bank against payment of money. The bank had, thus, become the owner of the securities and on the date the said brokers were notified person and, therefore, the dame could not be attached.

On behalf of the Custodian it was submitted by Mr. A.M. Setalvad that the said contracts were composite and unseverable, the illegality attached to the forward element of the contract rendering the contract wholly void. While relying upon the Halsbury Law of England IVth Ed. Vol. 19 paragraph 430 it was contended by Mr. Setalvad that in such a case there can be a no question of severing the illegal part from the legal part. The court, it was submitted, will not re-write or re-arrange the contract. Furthermore. Even if the part of the compromise could be struck off, the court will not do this if to so would alter entirely the scope and intention of the agreements.

It is not necessary to refer to other submissions which where advanced by the counsel for the parties as, n out opinion the above stated submissions on behalf of the appellants merit acceptance.

ARE THE READY-FORWARD TRANSACTIONS SEVERABLE :

We will first deal with the submission that the agreements in question were severable and ht illegality attached to the forward leg cannot effect the ready leg of transaction.

Mr. Chagla, appearing for ANZ Grindlays Bank while assuming that the ready-forward transaction was one composite transaction, submitted that the same was several into two parts each of which had separate consideration and a separate object. He submitted that provisions of Section 57 of the Contract Act were applicable to the present case and the first set of promises or the ready leg would constitute a binding contract while the second leg, namely , the forward leg would be void. In support of this contention reliance was placed on a decision of the Full Bench of the Nagpur High Court in Asaram and Ors. Vs. Ludheshwar and Ors. (AIR 1938 Nagpur 335). In that case a joint family was indebted to the defendants. It had proprietory share in land to which the provisions of the Central Provinces Tenancy Act applied. According to Section 49 of the said Tenancy Act alienation of 'sir' land, that is home farm land in cultivation, was ineffective unless the sanction of appropriate official had first been obtained. Section 49 of the said Tenancy Act postulated that if a proprietor lost his right to occupy any portion of the sir land as a proprietor he shall, as from the date of the losss, become an occupancy tenant of such 'sir' land. In order to alienate the interest in the said land a device was adopted to circumvent the provision of Section 49 of the said Act. On 14th April, 1923 two deeds were executed by the father of the appellants. By the first deed the proprietory right in the said land was sold for a sum of about Rs. 7367/- the appellants' predecessor in interest relinquished their occupancy rights in the 'sir' land. The appellants challenged the validity of the aforesaid deeds executed by their predecessors in interest and filed a suit for transfer of the land in question, inter alia, on the ground that the aid transactions were contrary to the provisions of Section 49 of the Tenancy Act and was, therefore, void. Taking note of the fact that the Act did not prohibit the transfer of the proprietory interest, because on such transfer the proprietor becomes and occupancy tenant of the 'sir', the Full Bench considered whether, in such a case, Section 24 of the Contract Act become applicable. While dealing with the case where the contract consisted of legal and illegal parts Mr. Justice Vivian Bose at page 343 observed as under :-

> "Therefore if this transaction had consisted of a single consideration for the two objects contemplated, namely, the sale of the proprietary rights (as distinguished from the occupancy rights) together with the occupancy right (which we usually somewhat inaccurately call cultivating rights in these Provinces), then the whole have fallen to the ground under this section unless the transferee had been content to accept the proprietary rights alone for the entire consideration and forgo the occupancy rights. But since the transaction consists of two separate considerations for two severable objects we are left with a contract consisting of legal and illegal parts in which the lawful is separable from the unlawful. In such a case it is always possible to give effect to the lawful and reject the unlawful; in fact the is what the Courts are bound to do unless the whole transaction is prohibited by statue or unless it involves serious moral turpitude or is otherwise against public policy. See S 57 and 58, Contract Act. This rule was applied and in my opinion rightly, to this very class of cases in 27 N L R 113 at p. 115 and 22 N L R 136 at P. 141. As I have said the whole transaction in this case is not prohibited by statue; on the contrary the part of it relating to the transfer of the proprietary rights is expressly allowed. Therefore under

> this rule since the considerations are separable that portion can, in may option, be enforced and it is only surrender which is of no effect..."

Section 57 applies to cases where two sets of promises are distinct. When the void part of an agreement can be properly separated from the rest, the latter does not become invalid. The ready-forward transaction consists of two parts. In the ready leg there is a purchase or sale of securities at a stated price which in executed on payment of consideration for the spot delivery of the security certificates together with transfer forms. The full and absolute ownership of the title in securities vests in the purchaser, the entire property in the security passing immediately upon such delivery and payment. The seller is divested of all the rights, title and interests in the said securities. The forward leg is to be performed at a later date on the stated price being paid. The securities are to be delivered beck when the title in interest therein would pass to the original seller. It is clear that such a ready- forward transaction consists of a set of reciprocal promises. The first set of promises were fully executed, but the second set remained executory. Section 57 of the Contract Act would thus be attracted to the present case, the effect of which would be that the first set of promises would constitute a binding contract but the second or the forward leg would be void and unforceable. Neither the object nor the consideration of the ready leg is illegal, unlawful or prohibited under section 23 of the Contract act. the forward leg is neither the consideration nor the object for entering into the ready leg. At best it may be that the forward leg provided the parties with the motive for entering into the contract but that would not affect the severability of the forward leg. Which alone is declared illegal under the Securities Control Regulation Act.

Mr. Chagla also relied on the decision in SEC V. Drysdale Securities 785 F 2d 3 : FED SEC L Rep. p 92, 487 at 92, Col 2. The US Court of Appeal had an occasion to deal with such a ready - forward contract In the case a broker entered into sale and re-purchase agreements (more Commonly known there as "Repos"). These agreements were structured as sales of securities by broker subject to an agreement to re- purchase them. from the other party, at a fixed price at a later date. The broker also entered into reverse sale and purchase agreement ("reverse repos") whereby he purchased government securities subject to an agreement to re-sell them, to the other party at a fixed price at a later date. The 'repos' and 'reverse repos' were thus description of the same transaction viewed from different sides. One of the questions which came up for consideration was whether such a transaction could be regarded as being a funding agreement or was it in the nature of a loan against collateral security. It was held by the US court of Appeal that there was a significant different between repos and standard collaterised loans. It was observed that " in the latter transaction . the lender holds pledged collateral for security and may not sell it in the absence of a default. In contrast, repo "lenders" take title to the securities received and can trade, sell or pledge them. The repo merely imposes a contractual obligation to deliver identical securities on the settlement date set by the repo contract and then proceed to hold that the secured lender in a repo is free to deal the collateral".

In the present case also some of the banks which had purchased the securities had sold them. There was, at no point of time, any stipulation between the parties that the banks could not trade in securities which have been purchased by them. The obligation to re-sell the securities to the notified person, in the forward leg of the agreement, could be fulfilled by the purchase by the appellants of

the securities from the market and then to sell them to the notified persons, in order to complete the forward leg. The trading in the securities purchased by the banks in the ready leg was not in conflict with any law. The appellants were free to deal with them. This would show that with the first or the forward leg of the transaction being completed the banks had become the absolute owners of the said securities and they could deal with them in any manner in which they liked. There was nothing in the terms of ready- forward transaction which prohibited the banks, if they had sold the securities, from purchasing the securities of the same value from the market an selling the same to the broker in order to complete the second or the forward leg of the transaction . This will itself show that the two legs of the transaction are severable.

It was contended by Mr. Setalvad that being a composite contract there can be no severance of the same. But the question of severance will arise only in the case of a composite agreement consisting of reciprocal promises. It is only in such a case that the court has to see whether the contract is such that the illegal or void part of the transaction can be severed. This is clearly evident from the decision in the case of Ram Sarup Vs. Mussumat Bela and ors. (Vol. XI Indian Appeals 44). There the Privy Council dealt with a case whether a person - Hearsey- had gifted certain properly owned by him to his second wife, generally called Vilayati Begum, and her three children on the condition of the wife obeying her husband and the children remaining faithful to their religion. There were decrees obtained by the predecessor in interest of the appellant against the said Hearsey. In execution thereof the transfer of the aforesaid property by Hearsey was inter alia challenged by suit being instituted by the decree holder challenging the gift by Hearsey on the ground that the said transaction was invalidated by the immorality of the consideration . It the transaction was invalidated then the property would have continued to belong to Hearsey and would have been available in order to satisfy the decree against him. It was contended before the Privy Council that by reason of Hearsey's decent and religion the case was to be governed by rules of English law and that the Begum could not be his lawful; that the stipulation as to her continuing to act as his wife was immoral; though she was under Mohammedan law, which allowed sexual relations forbidden to Christians; an that the gift was so thoroughly vitiated as to leave Hearsey, the grantor, still the owner of the properly in such a sense that the plaintiff could treat it as his right, title and interest liable to be sold under an attachment. While upholding the decision of the courts below in treating the gift to the Begum as resting on the valid and moral considerations, it was observed by the Privy Council as follow:-

> " Their Lordships are of opinion that the gift is in fact unconditional, because, as it was complete at the time when the actual transfer took place the parties could not after words import a condition ; and the petition must be treated as inefficacious for that purpose. But even if it were otherwise assuming a condition, and an immoral condition - it would be the condition that is immoral and not the consideration; and then the case would fall under the general rule of law that gift to which an immoral condition is attached remains a good gift. While the condition is void." (Emphasis added) In the case of a ready-forward contract the stipulation to re-transfer the securities, on a later date, can only be regarded as condition precedent and it is only this part condition which will fail.

It is not possible to accept the contention of Mr. Setalvad that severing the agreements into two parts would amount to re-writing or re-arranging the contract. We are here dealing with a case where there was one agreement. But which envisaged two sale transaction. Execution of each transaction envisaged the transfer of title in the securities. The valid part (the ready leg) of the transaction has been completed while the invalid part (forward leg) has to be ignored.

What notification issued under Section 16 did was to prohibit the entering into of a forward contract, i.e., sale at a future date for a fixed price. It expressly permitted sale of securities by spot delivery which, in the present case, is represented by the ready leg. It is only the further sale or the re-sale of the securities at a later date which the notification did not permit. This latter part of the agreement could not have been entered into and is clearly severable and cannot effect the transfer of the title which had already taken place at the time of the execution of the ready leg. This being so the securities which had been purchased by the appellants from the notified persons could not be attached.

POSITION IN LAW IF THE TRANSACTION ARE NOT SEVERABLE:

Even if it be assumed that the agreement were not severable, and they were composite agreements even then the ready leg having been performed, the position in law is that the illegality of the agreements cannot affect the transfer which had already taken place.

Reference may first be made to the decision of the Privy Council in Sajan Singh Vs. Sardara Ali (1960 A.C.

167). In that case the regulations which had been framed provided that no person could use or sell a motor vehicle for the carriage of goods without a haulage permit. Six motor vehicles were purchased by the appellant. The respondent paid part of the consideration towards the cost on the understanding that one of the vehicles, a dodge motor lorry, would become his property. The appellant executed a document of sale stating that he had sold the motor lorry jointly to the respondent and his friend, whose share the respondent subsequently purchased. Although the lorry was owned and operated by the respondent for the carriage of goods on his own account, the appellant registered the lorry in his own name and obtained a haulage permit which authorised its use by himself and him employees. The policy of the authority at the time was to restrict the issue of permits to persons who had them before the war. The respondent did not fall within that category, whereas the appellant did and that is why the permit was in the name of appellant but the lorry was paid for and operated by the respondent. In 1955, the appellant removed the lorry from the to return it. A suit was filed by the respondent/plaintiff against the appellant/defendant for the return of the lorry or its value. While upholding the decision in favour of the respondent, the Privy Council observed as follows:

> " Although the transaction between the plaintiff and the defendant was illegal, nevertheless it was fully executed and carried out: and on the account it was effective to pass the property in the lorry to the plaintiff. There are many cases which show that when two person agree together in a conspiracy to effect a fraudulent or illegal

> purpose-and one of them transfers property to the other in pursuance of the conspiracy-then, so soon as the contract is executed and the fraudulent or illegal purpose is achieved, the been transferred by the one to the other notwithstanding its illegal origin: see Scarfe V. Morgan per Parke B.
>
> The reason in because the transferor, having fully achieved his unworthy end, cannot be allowed to turn round and repudiate the means by which he did it-he cannot throw over the transfer. And the transferee, having obtained the property, can assert his tile to it against all the would, not because he has any merit of his own, but because there is no one who can assert a better title to it. The court does not confiscate the property because of the illegality- it has no power to do so-so it says, in the words of Lord Eldon: "Let the "estate lie where it falls", see Muckleston V. Brown. This principle was applied by the court of Appeal recently Bowmakers Ltd. V. Barnet Instruments Ltd. The parties to the fraud are, of course, liable to be punished for the part they played in the illegal transaction, but nevertheless the property passes to the transferee."

In conclusion it was observed that if the law were not to allow the plaintiff to recover i this case, then it would leave the defendant in possession of both the lorry and the money he had received for it. This, it was observed, was not the law.

It was submitted by Mr. Shanti Bhushan that even though the contract may have been illegal, the transaction of scale was independent of that and did not, in any way, affect the transfer of title in the securities. In support of this submission, reliance was placed on the following observations in Alexander Vs. Rayson, (1936 [1] KB 169) where at page 185 it was observed as follows:

> "The distinction between an action brought to enforce and unlawful agreement and one brought to assert a right of property already acquired under such and agreement is further illustrated by Taylor V. Chester (4). The defendant in that case was the keeper of a brothel and as such had supplied wine and supper to the plaintiff "for the purpose of being consumed there by the plaintiff and divers prostitutes in a debauch there, to incite them to ritous, disorderly, and immoral conduct." When the debauch was over there followed in due course the reckoning. Being unable or unwilling to pay it at once, the plaintiff deposited with the defendant the half of a 501.

note as security. He subsequently repented of this action, and instituted proceedings against the defendant for the purpose of obtaining the return of the half bank note. It was held that he was not entitled to recover. The property of the half note had passed to the defendant, and in spite of the illegality of the agreement under which it has passed, the defendant was entitled to keep it. as was said by the KB in Scarfe V. Morgan (5) in a passage quoted by Hannen J. in the course of the argument : "if the [illegal] contract is executed, and a property either special or general has passed thereby, the property must remain." The plaintiff, on the other hand, could not maintain his action without asserting and relying upon the unlawful agreement. He could not, to use the language Court, recover without showing the true character of the deposit; and that being upon an illegal

consideration, to which he himself was a party, he was precluded from obtaining "the assistance of the law" to recover it back." [Emphasis added] It would follow that if pursuant to a agreement to do an illegal act a transaction, in part, takes place which would otherwise be valid if there was no such prior agreement, than notwithstanding the illegality of the contract the said completed transaction itself cannot be regarded as invalid.

Tinsley V. Millingan ([1993] 3 All ER 65) was a case where the parties, who were living together, jointly purchased a house which was registered in the name of the appellant as the sole legal owner. Both the parties accepted that the house was jointly owned but it was registered in sole name of Tinsley so as to enable Millingan, with a knowledge and assent of Tinsley, to make false claims to the Department of Social Security for, some benefits. The money so obtained from the Department was shared between them. Subsequently, the parties quarreled and Tinsley moved out of the house which continued to be in occupation of Millingan. Tinsley brought an action claiming possession of the house and asserting ownership of it. Millingan counter-claimed for an order for sale and a declaration that the house was held by Tinsley on trust for the parties in equal shares. Tinsley contended, in regard to the counter claim that applying the common law maxim ex turpi cause no oritur actio, Millingan was barred from denying Tinsley's ownership because the purpose of the arrangement, whereby the house had been registered in the sole name of Tinsley was, to facilitate the fraud on the Department of Social Security and therefore, Millingan's claim to joint ownership was tainted by illegality. It was also contended that applying the equitable principle that he who came to equity had to come with clean hands, the court ought to leave the estate to lie where it fell since the property been conveyed into the name of one party for a fraudulent purpose which had then been carried out and in those circumstances the court ought not to enforce a trust in favour of the other party. Tinsley's claim was dismissed by the trial judge, who upheld the counter-claim of Millingan. The appeal filed by the appellant was dismissed by the Court of Appeal. Lord Jauncey in his speech, observed at page 82 that:

> " At the outset it seems to me to be important to distinguish between the enforcement of executory provisions arising under and illegal contract or other transaction and the enforcement of rights already acquired under the completed provisions of such contract or transaction. Your Lordships were referred to a very considerable number of authorities, both ancient and modern, from which certain propositions may be derived.
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> First: it is trite law that the court will not give its assistance to the enforcement of executory provisions of an unlawful contract whether the illegality is apparent ex facie the document or whether the illegality of purpose of what would otherwise be a lawful contract emerges during the course of the trial (see Holman V. Johnson (1775) 1 99 LR Lord Mansfield CJ., Pearce V. Brooks (1866) LR 1 Exch 213 at 217-218 [1861-73] Allow ER Rep 102 at 103 per Pollock CB, Alexander V. Rayson [1936] 1 KB 169 at 182 [1935] all Er Rep 185 at 191 and Bownkmakers Ltd. V. Barnet Instruments Ltd. [1944] 2 All ER 579 at 582 [1945] KB 65 at 70). Second: it is well established that a party is not entitled to rely on his own fraud or illegality in order to assist a claim or rebut a presumption. Thus when money or property children for the purpose of

defrauding creditors and the transferee resists his claim for recovery he cannot be heard to rely on his illegal purpose in order to rebut the presumption of advancement (see Gascoigne V. Gascoigne [1962] 1 KB 223 at 226. Chettiar V. Chettiar [1962] 1 All ER 494 A 498, [1970] 1 All ER 540 at 543, [1970] p 136 per Salmon LG).

Third: it has, however, for some years been recognised that a completely executed transfer of property or of a interest in property made in pursuance of an unlawful agreement is valid and the court will assist the transferee in the protection of his interest provided that he does not require to found on the unlawful agreement (see Ayerst V. Jenkins [1936] 1 KB 169 at 134-185, [1935] All ER Rep 185 at 191, Bowmakers Ltd. V. Barnet Instruments Ltd. [1944] 2 All ER 579, [1945] KB 65, Sajan Singh V. Sardara Ali [1960] 1 All ER 269 at 272-273, [1960] AC 167 at

176). To extent, at least, of his third proposition of would appear that there has been some modification over the years of Lord Eldon LC's principles". By posing the question whether the respondent in claiming the existence of a resultant trust in her favour was seeking to enforce unperformed provisions of an unlawful transaction or whether she was simply relying on a equitable proprietory interest that she had already acquired under such transaction, Lord Jauncy at page 83 observed as follows:-

"I find this a very narrow question but I have come to the conclusion that the transaction whereby the claimed resulting trust in favour of the respondent was created was the agreement between the parties that, although funds where to be provided by both of them, nevertheless the title to the house was to be in the sole name of the appellant for the unlawful purpose of defrauding the Department of Social Security. So long as that agreement remained unperformed neither party could have enforced it against the other. However, as soon as agreement was implemented by the sale to the appellant alone she became trustee fro the respondent who can now rely on the equitable proprietary interest which has thereby been presumed to have been created in her favour and has no need to rely on the illegal transaction which led to its creation."

Speaking for majority, Lord Browne Wilkinson first observed at page 85 as follows:

"Neither at law not in equity will the court enforce and illegal contract which has been partially, but not fully, performed. However, it does not follow that all acts done under a partially performed contract are of no effect. In particular it is now clearly established that at law (as opposed to in equity) property in goods or land can pass under, or pursuant to, such contract. It so, the rights of the owner of the legal title thereby acquired will be enforced, provided that the plaintiff can establish such title without pleading or leading evidence of the illegality. It is said that the to property was acquired as a result of the property passing under the illegal contract itself." (Emphasis added) Lord Browne Wilkinson the considered the decisions in the cases of Bowmakers Ltd. V. Barnet Instruments Ltd. [1944] 2 All ER 579, Feret V. Hill (1854) 15 CB 207 [1843- 60] All ER Rep 924.

Taylor V. Chester (1869) LR 4 QB 309 [1861-73] All ER REP 154, Alexander V. Rayson [1936] 1 KB 169 and observed at page 86 that :

"From these authorities the following propositions emerge.

(1) Property in chattels and land ca pass under a contract which is illegal and therefore would have been unenforceable as contract.

(2) A plaintiff can at law enforce property rights so acquired provided that he does not need rely on the illegal contract for any purpose other than providing the basis of his claim to property right.

(3) It is irrelevant that the illegality of the underlying agreement was either pleaded or emerged in evidence: if the plaintiff has acquired legal title under the illegal contract that is enough."

Even in the minority judgment of Lord Goff the passage from the speech of Lord Denning in Sajan Singh case (supra), quoted earlier, was noted with approval and at page 72, it was observed:

> "Even so, the mere fact that a transaction is illegal does not have the effect of preventing property, whether general or special, from passing under it. In Scarfe V. Morgan (1838) 4 M & W 270 at 281, 150 ER 1430 at 1434 Parke B said that 'if the [illegal] contract is executed, and property either special or general has passed thereby, the property must remain...' This principle has been applied on numerous occasions. Notable examples are to be found in Taylor V. Chester (1869) LR. 4 QB
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> 309. [1861-73] All ER Rep 154, Alexander V. Rayson [1936] KB 169, [1935] All ER Rep 185 and Sajan Singh V. Sardara Ali [1960] 1 All ER 269, [1960] AC 167."

It was submitted by Mr. Setalvad that the principle of low enunciated in the aforesaid decisions in England is restricted in its application to cases where the illegal contract has been performed and does not apply to an illegal contract which has been performed only in part. He contended that inasmuch as the ready-forward contract had only been performed in part, namely, as securities had been transferred under the first leg but the second leg was still to be performed, the principle laid down in the English cases would have no application. This contention of Mr. Setalvad cannot be accepted because the ratio of the said decisions is applicable even whether an illegal contract is partially performed as would be evident from the following observation of Lord Browne Wilkinson:-

> "Neither at law nor in equity will the Court enforce and illegal contract, which has been partially but not fully performed. However, it does not follow that all acts done under a partially performed contract are of no effect. In particular, it is now clearly established that at low (as opposed to equity) property, goods or land can pass under or pursuant to such a contract. " (Emphasis added) It was contended by the learned counsel for the respondent, and Mr. Jethmalani in particular, that the decisions of the courts in England should not be applied in India, where the validity of the contract has to be judged according to the statutory law applicable in this country.

It was submitted that under the Indian Contract Act the entire contract was void. The original contract could not be legally entered into and the title in the securities did not, in law, pass to the appellants.

While there can be no dispute the transactions in question have to be viewed in the context of the law in this country but the decisions of the court in England, based on common law principles, have been applied and followed by the courts in India. This will be evident from the fact that the decision in Sajan Singh case, which was approved by the House of Lords in Millingan case, has been followed by this Court in Smt. Surasaibalini Debi Vs. Phanindra Mohan Majumdar (1965) 1 SCR 860.

In Surasaibalini case the respondent (hereinafter referred to as the plaintiff) was employed at Calcutta in the Court of Ward and the service rules did not permit him to start of carry on any trade or business or his own. It was, therefore arranged with one Rabinder Mohan Gupta (hereinafter referred to as the defendant), that the defendant should be held be held out to be owner of the suit property, which was a Boarding House, of which the plaintiff was a true owner and the e plaintiff was put in its possession as Manager. The plaintiff had to leave Calcutta on medical advice and he put the defendant in possession on the understanding that when the plaintiff returns the defendant would hand over the possession. When the plaintiff returned to Calcutta and asked the defendant to hand over possession, he refused to do so. Thereupon, the plaintiff filed a suit in the Calcutta High Court for a declaration that he was the sole proprietor of the Boarding House, and also for the delivery of possession of the same.

The suit was decreed by the trial court, which decision was upheld in appeal. Before this Court it was contended by the defendant's successor in interest, namely, the appellant, that the suit should have been dismissed because the plaintiff admitted in his evidence that he had escaped payment of income tax by submitting a separated return for the salary earned by him in service, and by showing that the business income from the suit property belonged to the defendant and, therefore, the court should not countenance his claim and assist him in attaining possession of the suit property because that transaction had been entered into with a view to circumvent or defeat the provisions of the Income Tax Act. The plaintiff, while denying that the transaction was illegal, in the alternative, placed reliance on the aforesadi decision of the Privy Council in Sajan Singh case contended that the he had equitable interest in property and that the possession of the property should be restored to him. Gajendragadkar, C.J. and Shah, J. referred to the decision in Sajan Singh case but, while dismissing the appeal, held that the transaction of running the Boarding House was not entered into with a view to circumvent or defeat the provisions of the Income Tax Act and was, therefore, not illegal, Rajagopala Ayyangar, J. By separate judgment, Agreed that the appeal should be dismissed he held that from the evidence on record it was clear that the object of the agreement, entered into by the plaintiff, was to defeat the provisions of the Income Tax Act and was not lawful. The learned judge, however, applied the ration of the decision in Sajan Singh case and held that the plaintiff's claim to possession was independent and wholly disassociated from the illegal transaction and for this reason, the appeal should be dismissed. While coming to this conclusion Iyyangar, J. extracted the above quoted passage from the speech of Lord Denning in Sajan Singh Case and then observed as follow:

> "It would thus be seen that besides the claim based on his title to the lorry, the plaintiff had also established that while the chattel was in his possession, the defendant had unlawfully taken it away, with his consent. Insofar as his claim was based on this deprivation of possession, it was really and independent cause of action wholly separated from the original purchase of the lorry which was to circumvent the law, and as to his claim in detinue there was no question of its being tainted with any illegality. Besides this, Lord Denning himself pointed out that there were many cases which showed that where a transfer of property was effected in order to achieve an illegal purpose and that purpose was achieved, the plaintiff was disabled from recovering the property for the reason that the Court will not assist him in that endeavour."

It was rightly submitted by Mr. Shanti Bhushan that the aforesaid principles. Now well settled with the decision s of the House of Lords in Tinsley's case (supra), would be applicable in India as well. this is not a case where the appellant is seeking to enforce an illegal contract. On the other hand, it is Custodian who is referring to the illegality of the contract with a view to recover possession of the securities, the title of which already stands transferred in favour of the appellant.

In the present case the appellants are basing their claim by relying not on the terms of the ready-forward contract, but on the payment of market price against delivery of the securities. The claim to title is independent of the ready-forward agreement.

There can be little doubt that the appellants, when they paid the market price and took delivery of the securities, had become owners of the same. According to Section 5 of the Transfer of Property Act, 1882, 'transfer of property' inter alia means and act by which a person conveys property to another person. Section 6 of this Act deals with what property may be transferred. What is relevant in Section 6 (h) according to which no transfer can be made; (1) insofar as it is apposed to the nature of the interest affected thereby, or (2) for an unlawful object, or consideration within the meaning of Section 23 of the Indian Contract Act, or (3) to a person legally disqualified to be transferee. According to Section 23 of the Contract Act the consideration of object of an agreement will be unlawful if it is forbidden by law: or is such a nature that, if permitted, it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another; or the court regards it immoral of opposed to public policy. In the instant case the object of the contracts entered into between the banks and the notified parties was for the transfer and, subsequently, re-transfer of the securities. The transfer took place on delivery of securities. The transfer took place on delivery of securities on payment of market price as consideration. The consideration for the transfer of the securities, in the ready leg, was the payment of market price.

The validity of the transfer of the securities has to depend on the provisions of the Transfer of Property Act and the Sale of Good Act Relating to transfer and not to the validity of the agreement preceding the transfer. Like any other movable goods the securities could validly be purchased on delivery against payment of price as per Section 4, 19 and 20 of the Sale of Goods Act. The price paid, while taking delivery, was the consideration for the transfer of the securities. When the transfer of title has taken place that agreement between the parties preceding this cannot invalidate

the transfer. The ratio of the decisions in Sajan Singh Vs. Sardara Ali and Tinsley Vs Millingan and the observations of Rajgopal Ayyanger, J. in Surasaibalini Debi Vs. P.M. Majumdar (supra) are clearly applicable in the present case.

Inasmuch as, the aforesaid reasons are sufficient for the appeals to be allowed, we do not propose to deal with the other contentions which had been raised on behalf of the appellants.

CONCLUSIONS :

The following conclusions from the aforesaid discussion:

[A] Infringements of the instructions issued by the Reserve Bank of India under Banking Regulations Act prohibiting the banks from entering into by-back arrangements do not invalidate such contracts entered into between the banks and it's customer'.

[B] The ready forward contract is severable into two part, namely, the ready leg and the forward leg. The ready leg of the transaction having been completed, the forward leg, which alone is illegal, has to be ignored. [C] With the ready leg having been performed the illegality of the forward leg contained in the agreements cannot affect that the transfers which had already taken place.

The appeals are accordingly allowed. Judgment dated 14th December, 1993 of the Special Court is set aside, the effect of which would be that the applications filed by the Custodian and the notified persons for the return of the securities stand dismissed. There will be no order as to costs.