

## **CHAPTER XII**

### **BANK'S VARIOUS SECURITIES,**

### **RIGHTS AND LEGAL POSITION**

Bank's in course of their business mobilise deposits. Such deposits constitute lendable resources of the bank. Such resources have to be prudently and profitably deployed. Such funds belongs to the depositors/public and hence the banks have to discharge the obligations of repaying the deposit/interest as per the terms of deposit. Hence the bank has while lending the money keep in mind broad objectives that money advanced should come back in normal course of business and interest thereon is also recovered.

After nationalisation of banks in 1969 the lending pattern of the banks have undergone substantial change. The lending is not confined only to trade, industry and commerce but priority sector lending to agriculture, small scale industries, small borrowers etc. is also made.

The various modes by which such lending is made includes term loans, demand loan, cash credit, overdraft, bills financing, bridge loans etc.

### **PRINCIPLES OF SOUND LENDING**

1. **SAFETY** : Keeping in view the bank's own commitments to repay the deposits it is necessary that the credit worthiness of the prospective borrower is ascertained and economic liability of his project is also seen. It should be one of the banker's axioms to advance relatively moderate sums to many customers rather than large sums to a few customers. \*\*1

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\*\*1     SHELDON PRACTICE AND LAW OF BANKING

2. **PURPOSE** : Under the new economic policy banks have been seen as the channels through which balanced economic development has to be achieved. The lending by the banks hence has to be in consonance with social objectives. If Reserve bank has placed restriction on the advances, no loan can be given to such sector.
3. **LIQUIDITY AND SOURCE OF REPAYMENT** : Ideally speaking an advance should be granted to a reliable customer for an approved purpose for which repayments will be made in a reasonable period. \*\*2

Security hence is not the prime aspect of lending. Security serves the purpose only of some sort of an insurance against a catastrophic situation, unexpected, even unlikely but by no means impossible. \*\*3

### **ADVANTAGES OF SECURITY**

1. If default is committed by the borrower, the banker as secured creditor can take possession of security, sell the same and recover loan from the proceeds.
2. Charging of assets to an extent operates as control on behaviour of the borrower.
3. By specific charging of security a borrower is prevented from raising finance against the same security.
4. It ensures continuous involvement of the borrower and he can not leave the business at his will.
5. The charging of a security exhibits confidence of borrower in business.
6. End-use of funds for the purpose of lending is also secured by the same. \*\*4

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\*\*2 L C MOTHER QUOTED IN COMMERCIAL BANKING VOLUME 2

\*\*3 CLEMANS J. H. BALANCE SHEET AND LENDING BANKERS

\*\*4 M. N. SHEOREY THE BASIC PRINCIPLES OF LENDING PAGE 10.

Commercial banks grant two types of advances

1. SECURED ADVANCES
2. UNSECURED OR CLEAN ADVANCES.

The total bank credit sanctioned by banks as of September 1993 was 143771/- Crores and it included advances by State Bank of India ,its subsidiaries and 20 nationalised banks. The All India Financial Institutions sanctioned and disbursed as of September 1993 advances as under :-

<u>THE NAME OF INSTITUTION</u>	<u>AMOUNT</u> <u>(RS.IN CRORES)</u>
IFCI	1478
ICICI	2520
IDBI	4339
UTI	3178
LIC	491
SIDBI	1648
SHIPPING CREDIT COMPANY OF INDIA LTD.	1240 **5

Most of the aforesaid advances are secured advances in the sense that they are granted against security of some tangible assets like mortgage of land and building, hypothecation of stocks, book debts etc.

The bankers follow MAST principle to identify good security. It conveys

1. Marketability
2. Ascertainability
3. Stability
4. Transferability.

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\*\*5 SOURCE ECONOMIC SURVEY 1993-94 PAGE 562 AND 563

## I

**BANKERS' LIEN**

Lien is one of the traditional security available to a bank. The word lien in layman's language means right to retain property belonging to another until a certain debt due from the owner of the property is paid, and whose debt or claim is secured by a lien on particular property as distinguished from a general creditor, who has no such security is called lien creditor. \*\*6

**A. TYPES OF LIEN**

Lien is a generic term and includes both statutory lien and contractual lien.

A lien may be possessory, equitable or maritime. A possessory lien may further be classified into particular lien or general lien. A particular lien like say, right of finder of goods under section 168 or right of a bailee under section 170 of Indian Contract Act is a particular lien. Such lien arises out of possession and is lost if the possession is lost. \*\*7 Under the Indian Contract Act bankers, factors, wharfingers, attorney and policy brokers may, in the absence of contract to the contrary retain, a security for a general balance of account, any goods bailed to them but no other persons have a right to retain as a security for such balance, goods bailed to them unless there is an express contract to that effect. \*\*8

A banker's lien is different from bank's right to set off. Lien is confined to securities and property in bank's custody. Set off is in relation to money and may arise from contract or from mercantile usage or by operation of law.

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\*\*6 BLACK'S LAW DICTIONARY 6<sup>TH</sup> EDITION PAGE 923.

\*\*7 AIR 1987 CALCUTTA 46

\*\*8 SECTION 171 INDIAN CONTRACT ACT.

The provisions of an express contract to the contrary may exclude the claim of lien on the property. In a case before Karnataka High Court the bank had seized the vehicle belonging to the petitioner for non payment of hire purchase money and though the amounts were cleared by borrower, the bank claimed general lien on the vehicle for the amount due under some other account, for which the vehicle was offered as collateral security. The High Court held that in absence of right to seize the vehicle in event of default in payment under hypothecation deed, banker's general lien is not available and bank was directed to return the vehicle. \*\*9

In another case before the Supreme Court, the firm's goods and not those of its partners were pledged to the bank for grant of cash credit facility to the firm. It was held that the amount received from the insurer against claim for destruction of pledged goods has to be credited only in firm's cash credit account, it is not open to the bank to adjust the same for wiping out dues of firm's individual partners. \*\*10

## **B. NECESSARY CONDITIONS FOR OPERATION**

A lien does not require any special agreement, written or oral and it arises by operation of law provided the following conditions are fulfilled :-

- a) The creditor is in possession of goods, securities etc. and has come in possession thereof in ordinary course of business.
- b) The owner of goods, lawfully owes some amount to be paid to person in possession thereof.
- c) The exercise of such right is not barred by express or implied right to the contrary.

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\*\*9 1990 (1) KARNATAKA LAW JOURNAL AT PAGE 81.

\*\*10 AIR-1984, SC. 1012 GURBAX RAI V/s. PUNJAB NATIONAL BANK.

### C. PRINCIPLES GOVERNING BANKER'S LIEN

Section 171 of the Contract Act does not lay down any specific conditions in the matter of banker's lien. Several disputes have however arisen requiring interpretation of ambit and scope of banker's lien.

Money can be the subject of banker's lien but if the money is held under a special contract, it can not come under purview of lien.

Over a period of time, the decided court cases have settled the position of banker's lien on following points :-

- 1 The banker's lien is a right of retaining things delivered into his possession as a banker if and so long as customer to whom they belonged is indebted to the bank and the right was not expressly excluded. \*\*11
- 2 The banker's lien can extend only over things which belong to the customer. \*\*12
- 3 The Courts and jurists have distinguished between banker's right of lien and setoff. Lord Halsbury has expressed a view that money is usually not subject of lien unless there is specific earmarking and bank ordinarily has no lien on the funds in account of individuals with them. \*\*13
- 4 In case of money deposited the bank itself becomes the owner of the money. The purpose of lien in such cases is attained only by exercise of right of setoff.

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\*\*11 CHETTINAD MERCANTILE BANK LTD. CASE (AIR 1945, MAD.445)

\*\*12 PUNJAB NATIONAL BANK LTD. V/s. ARURA MAL(AIR 1960, PUNJAB.632)

\*\*13 HALSBURY'S LAWS OF ENGLAND. 3<sup>RD</sup> EDITION, VOL.2, PAGE 210.

5. The lien is subject to a contract to the contrary. The onus of proving that such contract exists is on the party who alleges it. The Delhi High Court held that when a Fixed Deposit was given as specific security for bank guarantee, the bank can not hold it for other liabilities. \*\*14
6. The terms on which securities are deposited may create merely a particular lien and not a general lien. In such case the banker is not entitled for general lien. \*\*15
7. Where securities have been charged for an advance which is repaid and securities are left with banker, the banker will have a lien on them for any advance subsequently or existing unless it is expressly excluded by original memorandum of charge. \*\*16
8. It is customary practice of the banks to insist for execution of separate letter of lien from customer by way of abundant caution enabling them to enjoy the security for all the liabilities of the borrower arising in any manner. It is taken to defend the argument that the securities were given only for specific purpose.
9. Unless an agreement not to set off is conclusively established by oral or documentary evidence, the bank was entitled to set off the balance in one account against other. \*\*17
10. A banker does not have lien when the contract by its very nature leads to contrary inference. Thus in following cases no lien can be claimed.

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\*\*14 VIJAYKUMAR V/s. JULLUNDER BODY BUILDERS, AIR 1981, DELHI 1981, PAGE.126)

\*\*15 SIR MACENZIE CHAMBERS, BILL OF EXCHANGE, 3<sup>RD</sup> EDITION, PAGE 92.

\*\*16 PAGET, LAW OF BANKING, 8<sup>TH</sup> EDITION, PAGE 502.

\*\*17 HALES OWENS CASE

#### **D. CASES WHERE BANK CAN NOT CLAIM LIEN**

- a) Safe custody deposits.
- b) Borrower does not have title on the movables.
- c) Bonds and coupons attached to bonds given in safe custody.
- d) Documents given for raising fresh loan.
- e) Bills entrusted for special purpose.
- f) If amount is not due no lien can be claimed.
- g) Funds in trust account where the banker has notice of trust. \*\*18
- h) Title deeds deposited for a specific obligation are beyond purview of lien.

#### **E. LIEN TO WHAT EXTENT IS IMPLIED PLEDGE**

Under the English Law, banker's lien is recognised as an implied pledge. The rights acquired by a general lien is an implied pledge and the banker gets privileges of pledgee. \*\*19

The position in India involves interpretation of atleast two statutes. The Indian Contract Act, Section 171 confines to lien only and it does not confer any power of sale. Under Section 171 general lien can be exercised on the goods which have been bailed. The term bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall when the purpose is accomplished be returned or otherwise disposed off according to the directions of persons delivering them.

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\*\*18 UNION BANK OF AUSTRALIA LTD. V/S.MURRAY (1898)AC 693

\*\*19 LORD CAMPBELL IN BRANDAO V/S. BARNETT – 1846 3CB 519

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As far as the power to sell and realise is concerned, Section 6(1)(f) of Banking Regulation Act 1949 says that it may manage, sell or realise any property which may come into its possession in satisfaction or part satisfaction of any of its claims. The Sale of Goods Act, excludes money from definition of goods.

Since the legal position on this aspect is not very clear, the bankers include within the scope of their security all the assets (present and future) of the borrower.

#### **F. LIMITATION ACT AND THE LIEN**

The law of limitation lays down the time period within which the action has to be initiated for enforcement of right in the court.

Limitation bars the remedy and not the right. Which means the rights, that can be exercised without the intervention of the court are neither barred nor precluded. In other words.

"The rules of limitation are not meant to destroy the rights of the parties. They are meant to see that plaintiff does not take dilatory tactics but seeks remedy within the period stipulated by legislature."\*\*20

The right continues to exist even though the remedy is barred by limitation.  
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\*\*20 BOB MITRA – LIMITATION ACT – 9<sup>TH</sup> EDITION PAGE 37

\*\*21 HARIRAJ SINGH V/S. SANCHALAK, AIR 1988 ALL 246

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Hence except in cases where the right itself is extinguished by lapse of time the remedy only is barred. If a barred debt can be recovered by any other means than by suit, the limitation does not prevent anybody from recovering the debt. \*\*22 Hence even if the amount payable to the banker has become barred by law of limitation, the banker's lien on the goods continues and the banker is not under an obligation to return the same merely because the recovery of amount is barred by law of limitation.

## II

### **RIGHT OF SET OFF**

#### **A. MEANING**

The banker maintains several accounts of a customer in one form or other. In its simplest sense the right to set off means the right of combination of several accounts.

English law does not recognise much difference between set off and counter claim.

Black's Law Dictionary defines set off as counter claim demand which defendant holds against plaintiff arising out of transaction extrinsic of plaintiff's cause of action. It is a remedy employed by defendant to discharge or reduce plaintiff's demand by opposite one which is extrinsic to plaintiff's cause of action.

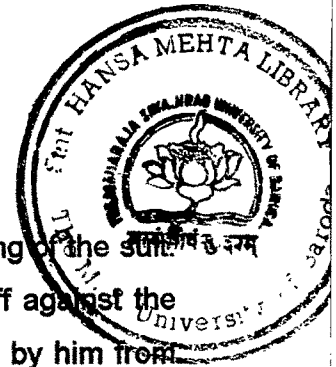
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\*\*22 FIRST NATIONAL BANK V/S. SETH SANTLAL .. AIR 1959 SC PAGE 328

\*\*23 BLACK'S LAW DICTIONARY SIXTY EDITION, PAGE 1372

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The defendant is entitled to take plea of set off at the first hearing of the suit. Where in a suit for recovery of money the defendant claims to set off against the plaintiff's demand any ascertained sum of money legally recoverable by him from the plaintiff, not exceeding the pecuniary limits of jurisdiction of court and both parties fall the same character as they fall in plaintiff's suit, the defendant may, at first hearing of suit, but not afterwards unless permitted by the Court, present a written statement, containing particulars of debt to be set off. \*\*24

The banker exercises right of set off, in most cases before filing of suit and claims only the net amount due after adjusting and appropriating the amount lying to the credit of customer.

Lord Denning has explained the concept of set off in following terms:-

"Suppose a customer has one account in credit and another in debit, has the banker a right to combine two accounts, so that he can set off the debit against the credit and be liable only for the balance? If the answer to this question is yes, the banker has a right to combine the two accounts wherever he pleases and to set off one against the other, unless he has made some agreement, express or implied to keep them separate". \*\*25

In India, under the Civil Procedure Code, a defendant in a suit may, in addition to his right of pleading a set off, set up, by way of counter claim against the claim of the plaintiff, any right or claim in respect of cause of action accruing to the defendant against plaintiff either before or after the filing of the suit but

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\*\*24 ORDER 8, RULE 6 CIVIL PROCEDURE CODE.

\*\*25 1971 41 COMP. CASES 239, HALES LTD. V/S. WEST MINISTER BANK LTD.

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before the defendant has delivered his defence or before the time limit for delivering the defence has expired, whether such claim is in nature of damages or not. Thus counter claim is a right additionally available with set off or in addition to it.

## **B. PRINCIPLES GOVERNING SET OFF**

The right of setoff available to a banker was in dispute in several cases under English Law and Indian Law. The settled position on this point now seems to be as under :-

- (i) The bank is entitled to combine accounts with its various branches without any notice to customer. \*\*26
- (ii) If a specific security is provided say for property loan and there is another current account, both the accounts can not be combined and if because of such combination loss occurs banker is liable.
- (iii) Bank has a right to setoff a customer's deposit against a bank loan advanced to him. \*\*27
- (iv) The right of setoff can be exercised even if the debt has become time barred. Though bank may not be able to institute suit on basis of same, the right is available. \*\*28 There is thus a difference between right of setoff exercised by the banker under mutual credit clause and the right of setoff which a defendant can exercise under order 8 rule 6 of Civil Procedure Code.
- (v) A separate debt can not be setoff against a joint debt whether at law or in equity. \*\*29

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\*\*26 (1872) LR 8, EXCH. 10

\*\*27 DEVENDRAKUMAR V/S. GULABSINGH (1946, COMP. CASES 89)

\*\*28 THAKUR PRASAD V/S. OFFICIAL LIQUIDATOR, BENERES BANK LTD.

\*\*29 NATH BANK LTD. V/S. SISIR KUMAR SARKAR

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- (vi) Lien will be operative against surplus amount after the sale of securities remaining in hands of banker, and can be utilised for discharging the liability of constituent even in capacity of guarantor.\*\*30

Hence it can be safely concluded in light of the aforesaid judgements that a banker is entitled to exercise right of setoff, subject to compliance of following conditions :-

- a) The amount of debt claimed by both parties against each other are certain.
- b) They are due to same parties.
- c) Such amounts are payable in the same right (i.e. not as trustee etc.)
- d) There is no contract, express or implied to the contrary excluding or curtailing exercise of such right.

### **III**

### **PLEDGE**

"Pledge" has been accepted traditionally as security by the banks particularly in respect of the commodities which can be readily sold.

Under section 172 of Indian Contract Act, pledge is a bailment of goods as security for repayment of a debt or performance of a promise. Hence the basic transaction in the case of a pledge is bailment and by virtue of the same the pledgee derives the special interest in the property and has a right to be paid in priority to the unsecured creditors.

A pledge is deposit of personal property to creditor as security for some debt or engagement. It is a security interest in a chattel or on tangible represented by on indispensable formal instrument as written evidence of an interest in such property.\*\*31

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\*\*30 PUNJAB NATIONAL BANK LTD. V/S. VIRMANI (1956, 26 COMP. CASES 135)

\*\*31 BLACK'S LAW DICTIONARY 6<sup>TH</sup> EDITION PG.1153

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## **B. INGREDIENTS OF PLEDGE**

The concept of pledge involves delivering possession from the pawner to the pawnee. The delivery may be actual or constructive. In some banks under key loan system the goods pledged remain under the lock and key of pledgee and the pledger has no direct access to them. Under open credit system the goods pledged remain in the pledger's actual possession and the pledgee has only constructive possession over them. Hence in key loan the pledger can not deal with the goods unless the goods are delivered by the pledgee.

Whether actual delivery of goods has taken place or not can be ascertained from surrounding circumstances. If document of title to goods are involved the matter has to be decided on basis of such circumstantial evidence. It was held that advancing of the loan by bank execution of promissory note and endorsement of railway receipt form one transaction and combined effect of it constituted a pledge.

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Hence the ingredients of the pledge may be summarised as under :-

1. There is a contract where under the banker agrees to lend the money and borrower agrees to pledge specified chattel.
2. Goods pledged should be actually or constructively delivered to the pledgee.
3. Pledgee has only a special property in the goods while general property remains in the pledger and which wholly reverts to him on discharge of debt.

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**\*\*32 AIR 1965 SC PAGE 1954**

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### **C. RIGHTS OF PLEDGEE**

A pledgee is entitled to continue with him the possession of the goods pledged till such time the debt is repaid with interest or the promise is performed. If a default is committed the pledgee can, (1) sue the pledger returning the goods pledged as a collateral security or (2) sell the goods after giving reasonable time to the pledger. What is reasonable time will depend on facts and circumstances of each case. If the sale proceeds are not sufficient to discharge the debt pledger will be liable to discharge the debt, and if there is any surplus, pledgee must pay such surplus.

The pledgee has no right to retain the goods pledged for any of the liability of the borrower unless he has agreed otherwise. The banks usually ensure the same by inserting additional conditions in the document of pledge.

### **D. ESSENTIAL FEATURES OF A PLEDGE**

In pledge the legal title to the goods does not vest in the pawnee and hence pawnee has no right of foreclosure because at no stage absolute ownership in the goods vest in him. If shares of a company are given in pledge the pawnee has no right to claim the status of holder of the shares, unless he has obtained transfer deed in his favour of shares and shares have been transferred in his favour. \*\*33

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\*\*33 AIR 1985 SC 520

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## **E. RISK INVOLVED IN PLEDGE**

In pledge the possession of the goods remains with the bank and there are inherent risks involved because of possession. As per Halsbury's Laws of England, \*\*34 pledge is a security whereby contract of deposit of goods is made and right to property vest in the pledgee as far as it is necessary to secure the debt. The special property of the pawnee is to be distinguished from mere right of detention and it is a transferable right. The right of a pledgee is superior to that of the right of the State, priority of pledgee can not be extinguished even if goods have been lawfully seized by the Govt. authority. \*\*35 Under the Indian Contract Act, bailee is required to take as much care as a prudent person will take of his own goods. If such a care is taken, then the pledgee is not liable. However if the goods are parted with or security is lost without consent of the surety the pledgee is by provision of Section 141 of Indian Contract Act liable and the borrower gets discharged to that extent. \*\*36 It is customary among the banks to stipulate in the agreement itself for the loss but since the obligation is statutory the courts were found reluctant in enforcing such conditions and the banks were held liable where negligence was clearly established. Hence a banker taking pledge as security make suitable arrangement for protecting his interest from risk involved and it is done in the following manner :-

- a) Inserting inbuilt condition in document of pledge to safeguard the interest.
- b) Arranging for adequate insurance of the pledged goods at borrower's cost and such policies assigned in favour of the bank.
- c) Arranging for protection and preservation of the security at the cost of the borrower.
- d) Execute the right to sell the goods in case of perishable commodities.
- e) Insisting for a collateral security in form of mortgage etc.

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\*\*34 HALSBURY'S LAWS OF ENGLAND PG.211 3<sup>RD</sup> EDITION

\*\*35 AIR 1971 SC 1210

\*\*36 STATE BANK OF SAURASHTRA V/S. C. R. RAJA AIR 1980 SC 1528.

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**IV****HYPOTHECATION****A. THE CONCEPT**

Hypothecation is not defined under any Indian laws but that in no way reduces its significance from banker's point of view.

There are several obligations to be complied by the pledgee and hence security in form of pledge has certain inherent limitations and risks. The concept of hypothecation has therefore assumed importance. A pledge in strict sense, presupposes delivery given by pledger to the pledgee and the pledgee is expected to release the materials as and when approached by pledger with proportionate payment. In manufacturing/trading units bankers finance working capital and the goods/raw materials undergo constant process of transformation which make it difficult for creditor to exercise physical control on the movement of goods. It will be next to impossible for the banker to supervise the day to day activities of the borrower. Hypothecation therefore is a convenient and practical solution to the problem of operational difficulties involved.

In hypothecation possession of the property in goods and other movables remain with the borrower and only an equitable charge is created in favour of the lender \*\*37 The concept of hypothecation of property is however well recognised under the Indian Law.

The charge is normally created by written instrument known as DEED OF HYPOTHECATION. Such charge is shifting and ambulatory in nature without being attached to any fixed property. It hovers over and floats with the property and the borrower has every freedom and right to deal with such property until some event like default in compliance of conditions agreed between the bank and the borrower, causes it to settle and seize on the hypothecated assets.

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\*\*37 COMMERCIAL BANKING, VOLUME II PAGE 31

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## **B. FLOATING CHARGE**

Hypothecation is recognised as floating charge on movable assets.

It is a continuing charge on the assets of the company creating it, but permitting the company to deal freely with the property in the usual course of business until the security holder shall intervene to enforce the claim. \*\*38

The concept of reputed ownership also therefore becomes applicable. The charge by way of hypothecation is equitable because the borrower who is in possession of goods sells such goods and if bonafide purchaser who has no notice of charge of the bank purchases such goods or creates pledge of such goods in favour of another innocent lender.

The position in India in respect of limited companies registered under the Companies Act, 1956 is different. In such case charge by way of hypothecation is required to be registered under Section 125 of Companies Act 1956. \*\*39

The borrower can sell the goods because he is in possession of goods. The bankers hence invariably stipulate that the sale proceeds of the goods which come in borrower's hands shall be forthwith deposited with the bank and in case the same are reflected in form of bills the bills are discounted/purchased with the bank.

The Hypothecation documents apart from movables like goods/machineries etc. also cover the amount to be realised by the borrower in form of book debts. The bank acquires additional powers to realise the book debts and appropriate the same towards the outstanding liability.

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\*\*38 BLACK'S LAW DICTIONARY 6<sup>TH</sup> EDITION PAGE 640

\*\*39 COMPANIES ACT. 1956 SECTION 125

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In case of hypothecation the borrower is required to submit stock statement at periodic intervals and maintain adequate margin. The drawing power, i.e. the limit upto which the borrower can draw cheques is decided on basis of the same.

For the purpose of extensive study, documents of hypothecation of various banks were examined and the same inter alia includes the power to repossess and sell the hypothecated assets by private treaty or public auction.

Recently there was very heavy increase in stamp duty payable on document of hypothecation in State of Gujarat, \*\*40 comparative study of the increase in stamp duty on deed of hypothecation shows the quantum and impact of such increase.

<u>PERIOD</u>	<u>STAMP DUTY ON HYPOTHECATION/ PLEDGE DOCUMENTS.</u>
PRIOR TO 1/4/97	RS.20 (IRRESPECTIVE OF AMOUNT)**41
AFTER 1/4/97 UPTO 31/7/98	0.1% OF THE AMOUNT SECURED **42
1/8/98 ONWARDS	1% OF THE AMOUNT SECURED SUBJECT TO A MAXIMUM OF RS.2 LACS.

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\*\*40 ARTICLE 6 OF THE SCHEDULE TO BOMBAY STAMP ACT.

\*\*41 GOVT. NOTIFICATION NO. 13 PART 12(2) DATED 1/4/97

\*\*42 GOVT. NOTIFICATION DATED 1/8/98

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Thus for the companies availing finance of more than Rs.2 Crores the increase is 10000 times. There are several representations from industries for reduction in stamp duty and bankers also should take initiative for the same.

Before the increase in stamp duty banks were obtaining separate documents for hypothecation of goods, bookdebts, machineries etc. Now most of the banks have introduced common documents covering all the securities viz. goods, bookdebts, machineries etc. This avoids incidence of multiple payment of stamp duty for the same advance.

### **C. DISTINCTION BETWEEN PLEDGE AND HYPOTHECATION**

'Pledge' and 'Hypothecation' are considered to be the modes of charging security in favour of the bank.

The Jammu and Kashmir High Court distinguished between pledge and hypothecation and stated the position of law in following words :-

"Transaction of pledge and hypothecation do have a common ingredient in as much as both of them create security in hypothecated or pledged goods for repayment of goods and ownership of goods remains with person hypothecating or pledging. Nevertheless there is distinction between two transactions and unlike a pledge where possession of goods must pass on the pawnee, no possession passes on to the creditor in case of hypothecation. \*\*43

The High Court of Orissa, again gave heavy emphasis on the aspect of possession and explained the difference in following terms :-

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**\*\*43 STATE BANK OF INDIA V/S. VICTORY EXPORTS AND OTHERS. AIR 1978 J & K. 76.**

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"In case of pledged goods, the goods are stored in the godown under the lock and key of the bank under the bank's supervision. Thus pledged goods remain under physical possession of bank and no withdrawal or addition of stocks is allowed without bank's permission.

The position with regard to hypothecated goods is however different because those goods strictly speaking are not under the lock and key of bank as such but are supposed to be under constructive possession of the bank by virtue of deed of hypothecation under which the borrower is obliged to submit regular returns to bank indicating increase and decrease in value of said goods." \*\*44

The Gujarat High Court in a more recent case, pronounced the position of law in following words, in a case involving a vehicle hypothecated to the bank, allegedly for claim of vicarious liability against the bank in case of accident....

"Unlike in case of pledge, in hypothecation the possession of movables continue to remain with the borrower. The jural relationship which comes into existence is therefore that of a creditor and debtor. The defacto and dejure possession remains with the owner and the bank gets a right to get the amount by sale of vehicle in the event of default. The hypothecating bank thus does not step into the shoes of owner to discharge liability for payment of compensation on bank" \*\*45

Though hypothecation is not defined under Indian Contract Act or any other law, its legal recognition is beyond doubt. Madras High Court examined this aspect and settled the position of law as under :-

"Hypothecation is neither pledge nor mortgage of movables. State therefore has priority over amounts due under hypothecation". \*\*46

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\*\*44 B. S. PATRA V/S. STATE BANK OF INDIA AIR 1986 ORI.247

\*\*45 AIR 1987, GUJARAT – 1.

\*\*46 (1978) 48 COMP. CASES 640

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Law Lexicon explains the concept of hypothecation in following words :-

"Hypothecation is a pledge in which the pledger retained possession of the thing pledged as security for a debt. It differs from a mortgage in that there is no actual or executory conveyance or assurance of the property hypothecated for payment of the debt or loan, and from a pledge in that there is no actual or constructive delivery of the property."\*\*47

Hypothecation means to pledge property as security or collateral for a debt. Generally, there is no physical transfer of the pledged property to the lender, nor is the lender given title to the property; though he has the right to sell the pledged property upon default.\*\*47A

#### **D. HYPOTHECATION – RECENT POSITION**

The pawner has right to redeem possession of goods till such time pawnee actually sells it. No title in goods passes to the pawnee. The pawnee only has right to retain the goods till such time payment is not made. The pawnee has no right to charge interest if pawnee was not in a position to sell the goods because of supervening impossibility. \*\*48

The delivery of possession in case of goods can be actual or constructive. In case when loan is given by bank by discounting of bills and GRIRR is prepared by the transfer showing name of bank as consignee, the title vests in bank because of money advanced. Though it may not be strictly a pledge the case stands on better footing when loan is advanced by the bank and goods and documents of title there to have been deposited as security thereof. If the goods are seized by Sales Tax Authorities the right of bank is prior and after sale of goods if there is surplus, the State can claim priority only after discharge of liability of bank. Hence the State's dues do not get priority. \*\*49

\*\*47 VENKATRAMAYA'S LAW LEXICON, 5<sup>TH</sup> EDITION, VOL.I, PAGE 568

\*\*47A BLACK'S LAW DICTIONARY 6<sup>TH</sup> EDITION PAGE : 742.

\*\*48 SMT.AARTIBALA MOHANTY V/S.SBI I(1991) BC 577

\*\*49 SBI V/S. STATE OF RAJASTHAN & OTHERS, I (1995) BANKING CASES 449.

Though pledge is governed by Indian Contract Act, at times the right of bank as pledgee may come in conflict with provisions of other laws. In a case before Madhya Pradesh High Court the goods (Soyabean) were confiscated under Section 6 A of Essential Commodities Act. The court held that right of pawnee who has parted with money in favour of the pawner on the security of goods can not be extinguished even by lawful seizure of goods by Government under provisions of Essential Commodities Act. After the seizure the Government is bound to pay money to the pledger and only balance will be available to other creditors. If the Govt. deprives the pawnee of the amount due, Govt. is bound to reimburse him for such amount which he in ordinary course would have realised upon the pawner making default in payment of debt.\*\*50

In case of pledge, the legal title to the goods does not rest in the pawnee and he has only those rights as defined under the Central Act.

## **V**

### **MORTGAGE**

'Mortgage' is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, or an existing or future debt, or the performance of an engagement which may give rise to pecuniary liability.\*\*51

Mortgage is a concept of ancient origin which can be traced back to earliest phases of human civilisation and commercial transactions.

The Transfer of Property Act, defines mortgage in terms of transfer of interest in immovable property. It is a right in rem which enables the person entitled to it to secure the payment of a pecuniary claim through the medium of property itself which is pledged to him.

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\*\*50 BANK OF BARODA V/S. COLLECTOR, INDORE & OTHERS I(1993) BC 445.

\*\*51 SECTION 58, TRANSFER OF PROPERTY ACT. 1882.

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In most modern systems of law, the transaction is effected by the mortgager parting neither with his possession nor his ownership even conditionally, but only with the right of sale which constitutes one of the attributes of ownership. In this sense, a mortgage may be described as a right enabling the mortgagee to satisfy his demand by sale of property given to him in security. The mortgager continues in possession of property and also remains owner of property, the mortgagee being only entitled in the event of default to insist upon a sale of the property.\*\*52

In mortgage transaction the transferor is called mortgager, the transferee the mortgagee, the amount is called mortgage money and document creating it is called mortgage deed.

Tracing the history of mortgage and securities, Mulla observes that in ancient systems of law a mortgage was really a pledge, the property being a security which was forfeited on default in payment. The transaction was affected by actual delivery of possession or by conditional conveyance. The Roman Law recognised fiducia as earliest form of security in which property was forfeited in case of non-payment. \*\*53

The common law recognised the condition of defiance and the right of mortgager that on repayment the mortgage stands determined and the property reverts back to mortgager who had right to re-enter.

Common law applied following three principles of equity to protect exploitation of mortgager:-

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\*\*52 RASHBIHARI GHOSH ON LAW OF MORTGAGES PAGE 20, 7<sup>TH</sup> EDITION.

\*\*53 SIR.D. F. MULLA, TRANSFER OF PROPERTY ACT, 7<sup>TH</sup> EDITION PAGE 350.

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- i) Equity looks to the essence of the transaction and the mortgage is in essence a borrowing transaction.
- ii) The borrower (mortgager) is in need of protection and any condition that penalises him is void.
- iii) A condition of forfeiture in default of payment on due date is a penalty.

These same equitable principles have been applied to mortgages in India also. \*\*54

The Privy Council, described mortgage as some right in addition to the personal binding. The essence of transaction by way of loan on security is that the lender unwilling to rely solely on the personal liability of borrower to be given a right in rem and to insist in the same document, provision by which the borrower bestowed the right in rem. \*\*55

#### A. TYPES OF MORTGAGE

**Under English Law** :- By cases, convention and practice 33 types of mortgages prevail under English conveyancing. A brief reference of each of them is as under.

- (a) **Adjustable rate mortgage (ARM)**:- It is a mortgage in which the interest rate is not fixed, it is linked to an index and is periodically adjusted as rate index moves upon. Generally it also provides for an option for the mortgager to convert to fix rate mortgage.

\*\*54 MULLA, T. P. ACT, 7<sup>TH</sup> EDITION PAGE 351.

\*\*55 NATHALAL V/S. RAMANMAL AIR 1937 (PRIVYCOUNCIL) 124

- (b) **Amortized Mortgage**:- In this transaction the mortgager pays the amount in installments which covers current interest and also portion of the principal.
  - (c) **Ballon Payment Mortgage**:- Interest is paid periodically and full payment of the principal is made at the end of the period.
  - (d) **Blanket Mortgage**:- The mortgager conveys title on all his assets or a substantial portion of them rather than on specific asset.
  - (e) **Chattel Mortgage**:- Mortgage secured by personal property.
  - (f) **Consolidated Mortgage**:- A single mortgage given to replace or to combine several outstanding mortgages.
  - (g) **Close end Mortgage**:- Neither the property mortgaged nor the amount borrowed may be altered during the term of mortgage.
  - (h) **Construction draw Mortgage**:- This is a mortgage used to finance construction project etc.
  - (i) **Conventional Mortgage**:- The Mortgage is a contract by which a person binds whole of his property or part of it in favour of another to secure the execution of some engagement but without divesting the possession.
  - (j) **Conventional home Mortgage**:- It is used by those who wish to purchase a home by transferring to the bank or other financial institution for defeasible legal title in return of the price of the home.
  - (k) **Direct Reduction Mortgage**:- It is amortized mortgage on which principal and interest are paid at the same time and interest is computed on reducing balance.
  - (l) **Equitable Mortgage**:- A specific lien on immovable property to secure payment of money which a Court of equity will recognize and enforce.
  - (m) **First Mortgage**:- The first of a series of two or more mortgages covering the same property and successively attached to it. First Mortgage Bond is a bond, payment of which is secured on property.
  - (n) **General Mortgage**:- It is a mortgage which binds all property present and future.
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- (o) **Future advance Mortgage:-** A mortgage transaction where part of the loan proceeds will not be disbursed until a future date.
  - (p) **Graduated Payment Mortgage:-** A mortgage that carries monthly payments which increase annually by a specified percentage during early years and then become constant.
  - (q) **Growing equity Mortgage:-** Payments are fully amortized over short period and increase every year.
  - (r) **Joint Mortgage:-** When property is given to two or more mortgagees jointly.
  - (s) **Judicial Mortgage:-** A lien resulting from judgement whether final or provisional in favour of person obtaining them.
  - (t) **Junior Mortgage:-** It ranks below another mortgage of the another property and is subordinate to other mortgage.
  - (u) **Leasehold Mortgage:-** Mortgage secured by Lease-hold property.
  - (v) **Legal Mortgage:-** A mortgage created by law in favour of a creditor.
  - (w) **Open End Mortgage:-** It permits the mortgager to borrow the money under the same mortgage.
  - (x) **Package Mortgage:-** Includes not only the real property but many items of personal property such as refrigerator etc.
  - (y) **Purchase Money Mortgage:-** Mortgage given to secure the loan for the purpose of acquiring the land for which the mortgage is given. It is given concurrent with purchase of land.
  - (z) **Reverse Annuity Mortgage (RAM):-** Mortgage loan is disbursed over a long time period to provide regular income for the Mortgager and is repaid in a lump sum.
  - (aa) **Second Mortgage:-** It ranks immediately after a first Mortgage without any intervening lien and is entitled to satisfaction out of proceeds of the property.
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- (bb) **Senior Mortgage**:- One which ranks ahead of another in terms of rights in the security.
- (cc) **Shed appreciation Mortgage**:- It gives the lender the right to recover as contingent interest some agreed percentage of property's appreciation in value.
- (dd) **Shed equity Mortgage**:- A purchaser occupant and another person become co-owner/co-mortgager of real estate. No occupant owner pays the loan and is entitled to share in appreciation when real estate is sold.
- (ee) **Straight Mortgage**:- The mortgagor is to pay interest during term of mortgage and final payment of principal at the end of the term.
- (ff) **Variable rate mortgage** :- A long term mortgage which permits the lender upward and downward the interest rate in response to charges in money market.
- (gg) **Wrap around mortgage** :- It is a second mortgage which wraps around in addition to first mortgage. It is a secondary financing.

Under Indian Law 6 types of mortgages have been recognised. The same are as under :-

- A. Simple mortgage.
- B. Mortgage by conditional sale.
- C. Usufructuary mortgage.
- D. English Mortgage
- E. Equitable Mortgage
- F. Anomalous Mortgage

Each type of mortgage have specific legal attributes. Thus the attributes of simple mortgage as summarised by Lord Parker are given below :-

- I Loan prima facie involved a personal liability.
- II Liability is not displaced by mere fact that security is given for repayment.
- III Nature and terms of the documents may exclude personal liability. \*\*56

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\*\*56 R. N. SINGH V/S. ADHINDHRANATH AIR 1970 CAL.388

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No possession is given to the mortgagee in simple mortgage.

In case of mortgage by conditional sale, there is an ostensible sale and the condition operates as security for the debt. In case, payment is made as stipulated the sale becomes void and mortgage will re-convey the property.\*\*57

In usufructory mortgage, mortgagee is placed in possession of property and also has a right to enjoy the rent and profits until debt is paid. The possession may be passed on symbolically say by directing the tenants in the property to pay the rent to mortgagee. Possession of the mortgagee is a distinguishing feature.

A usufructory mortgagee may even lease back the property to the mortgagor himself. In this mortgage the mortgagor does not incur personal liability.

In English mortgage there is a transfer of property to mortgagee with a covenant to repay the debt on a given date and a provision that on this condition being performed, the mortgagor will be entitled for re-conveyance. Madras High Court has summarised the essentials of English mortgage and held that:-

1. The mortgagor shall bind himself to repay the mortgage money on certain day.
2. Property mortgaged should be transferred absolutely.
3. Absolute transfer is subject to proviso that mortgagee will re-convey the property to mortgagor. \*\*58 In English mortgage personal debt also remains.

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\*\*57 TRANSFER OF PROPERTY ACT BY MULLA PAGE 371 7<sup>TH</sup> EDITION

\*\*58 APTE V/s. PRICE AIR 1962 AP 274

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In case of equitable mortgage the titles have been deposited with an intention to create security. The concept originates from English Law which has over a period of time recognised a well established rule of equity that a deposit of document of title without anything more, without writing, without even word of mouth will create in equity a charge on the property referred.\*\*59

In Indian context it has been held by privy council, though there was no conveyance an equitable mortgage affected a transfer of property for purposes of priority on the same footing as a mortgage by deed.

The requisites of an equitable mortgage by deposit of title deeds are :-

- (a) A debt
- (b) A deposit of title deeds at notified place
- (c) An intention that deeds shall be a security for the debt.

In case of equitable mortgage no document in form of mortgage deed is required to be executed. In that sense, equitable mortgage is a convenient and time saving mode of creating mortgage and hence is widely popular among the bankers.

Physical delivery of documents is not the only mode of creation of mortgage. Thus when title deeds are already in possession of creditor, it would be hypothetical to insist upon the formula of creditor delivering the title deeds to the debtor and debtor redelivering it to the creditor.\*\*60

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\*\*59 LORD CARNES IN SHOW V/s. FOSTER (1872 L. R. 5 HL 321)

\*\*60 NATIAN V/s. S. V. M. REDDY AIR 1965 S. C. PAGE 430.

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In India, in case of property acquired as ancestral property title deeds like registered sale deed are not available and creation of equitable mortgage in such cases becomes difficult. Similarly copies of sale deed are not title deeds and hence no equitable mortgage can be created on basis of the same.\*\*61

Usually the transaction of deposit of title deeds is recorded by preparing a memorandum called memorandum of entry. If this writing by itself is a contract of mortgage it has to be registered. The Supreme Court has held that :-

"The Crucial question is, did the parties intend to reduce the bargain regarding the deposit of title deeds to the form of a document? If so, document requires registration. If on the other hand, its proper construction and surrounding circumstances lead to the conclusion that the parties did not intend to do so, then there being no express bargain, the contract to create mortgage arises by implication of law from deposit itself with requisite intention, and the document itself, being merely evidential does not require registration.\*\*62

Anomalous mortgage is a mortgage which does not fall within any of specific categories mentioned earlier. It may be in form of simple mortgage usufructory or usufructory mortgage by conditional sale. The traditional forms like otti and Kanom places restriction on redemption of property before 12 years. In otti right of preemption is also available. Kanom is combination of mortgage and lease.

The limitation period for enforcement of mortgage is 12 years from the date when mortgage money became payable.\*\*63

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\*\*61 MULLA - TRANSFER OF PROPERTY ACT, 7<sup>TH</sup> EDITION PG.386

\*\*62 JUSTICE PATANJALI SASTRI IN RACHPAL MAHARAJ V/S. BHAGWANDAS 1950, AIR SC 272

\*\*63 LIMITATION ACT, 1963 ART.62

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Under the Indian Law mortgagor is entitled to the following rights and protection to the law.

**RIGHT OF DEDEMPION** :- In a finer analysis there are 2 distinct rights of redemption.

- (a) Legal or contractual right to redeem on appointed day as mentioned in deed.
- (b) Equitable right to redeem thereafter.

According to Halsbury the mortgagor in free hold estate can not have an equitable estate co-extensive with and as such the equity of redemption subsist only as a right in equity to redeem the property and is attached to mortgagors, legal estate.\*\*64

Under the Indian Law the mortgagor on redemption of mortgage gets back his own right. He is not the successor in interest of the mortgagee. Interest if any created by the mortgagor on mortgagor's right must disappear upon ceasing of interest of the mortgagee.\*\*65

Obtaining decree for redemption will not be sufficient and unless actual payment is made the mortgagee shall be entitled to exercise all his rights. The payment can be made even during execution proceedings.\*\*66

Mortgagor is entitled to file suit to enforce his right to redeem. The right of redemption would ordinarily arise after principal amount has become due or payment of interest is not made. It is open to the mortgagor to move the court

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\*\*64 HALSBURY'S LAWS OF ENGLAND 3<sup>RD</sup> EDITION VOL.3 PG.131

\*\*65 CARONA SHOE CO.LTD. V/s. K. C. NAIR AIR 1989 SC 1110

\*\*66 MANCHERY V/s. KUTHIRAVATTAL 1996 6 SCC 185

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even before expiry of stipulated period if condition as to interest are found oppressive.\*\*67 All agreements for forfeiture of right to redeem are void the doctrine is known as "Once a mortgage always a mortgagee".\*\*68 Any condition which prevents the mortgagor from redeeming the property is known as "Clog on redemption" and will not be enforced by the court. \*\*69 The mortgagor is also entitled to the following rights as rights incidental to redemption.

- (i) Assignment and inspection
- (ii) Right to get back the title deed.
- (iii) Right to accounts
- (iv) Right to Accretions and improvement.
- (v) Right of separate or simultaneous enforcement.
- (vi) Right to lease and its renewals.

### **LIABILITY OF THE MORTGAGOR**

The mortgagor binds himself for payment of mortgage debt and also gives warranties as stipulated under Section 65 of the transfer of property Act. The same are as under :-

1. The interest which the mortgagor transfers subsists and mortgagor has power to transfer the same.
2. The mortgagor will defend or enable the mortgagee to defend his title.
3. Mortgagor will pay all public charges if he continues in possession of property.
4. If mortgage property is lease hold all conditions of lease will be complied.

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**\*\*68** GHANCHI v/s. GOSAI 1995 AIHC 134 GUJ.

**\*\*69** LORD NOTTINGHAM IN HARRIS V/s. HARRIS.

**\*\*70** GANGADAS V/s. SHANKARLAL AIR 1958 SC 770.

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If it is a second mortgage the amount under the first mortgage will be paid.  
The mortgagee has the following rights and liabilities :-

1. **The right of foreclosure** : This right entitles the mortgagee to obtain an order from the court that the mortgagor shall be absolutely debarred to redeem the property or a decree that the property be sold . In English mortgage the property can be sold without intervention of the court.
2. The mortgagee has right to sue for the mortgage money in following circumstances:-
  - (a) Where the mortgagor binds himself to repay the same.
  - (b) The mortgagee is deprived of the whole or part of security by wrongful act or default of mortgagee.
  - (c) Mortgagee was entitled to possession and mortgagor fails to deliver the same to him despite express obligation to that effect.\*\*71
3. The mortgagee is entitled to any accession to the property.
4. The mortgagee is entitled to reimbursement of expenses incurred for protection of the property required for redemption.

In case the property is auctioned or acquired by the Govt. the mortgagee is entitled to claim dues from proceeds of the same.

### **LIABILITY OF MORTGAGEE**

- (i) Manage the property as person of ordinary prudence will manage.
- (ii) Must make best endeavors to collect income of property.
- (iii) Make reasonable repairs unless contracted out.
- (iv) Should not indulge in any act destructive to the property.
- (v) Keep property insured if so agreed.

### **B ADVANTAGES OF ENGLISH MORTGAGE**

In English mortgage the essential attributes are,

- (i) Mortgager binds himself to repay the money by a given day.
- (ii) The absolute transfer is subject to absolute proviso that mortgagee will re-convey the property upon payment. Under this mortgage, mortgagee is entitled to all rights of the mortgagor including right of redemption. Sometimes constructive possession may be with the mortgagee with a further covenant that mortgagee shall be entitled to enter into actual possession.\*\*72 Thus in English mortgage the advantage with the mortgagee is that the time involved in approaching a court for getting the decree is saved. That apart, the possession of mortgagee can prove advantageous to prevent any alienation of the property.

An English mortgage can be created only by a registered document and hence additional expenses like stamp duty, registration fees etc will be incurred.

Under section 230 A of Income Tax Act, a document involving an amount of more than Rs.5 lacs will not be registered without obtaining certificate from the assessing officer as per the Income Tax Act.

The English Mortgage is usually taken by financial institutions who give long term loan to their borrowers in case of debenture trust arrangements. In some cases legal mortgage with an option to convert in a English mortgage is also inserted as part of the Government.

### **C. EQUITABLE MORTGAGE AND ITS ADVANTAGES**

The biggest advantage of equitable mortgage is its simplicity, less expenses and less time involved in completion of formalities. No complicated drafting is involved. No re-conveyance is required because the mortgage is not created by registered document.

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\*\*72 DR. H. S. GOUR TRANSFER OF PROPERTY VOL.2 PAGE 893

#### **D. MORTGAGE SUITS**

Order 34 of the Civil Procedure Code provides for the procedure in mortgage suits. Such suits can be filed for enforcing claim in respect of mortgage property. All persons having an interest in mortgage security or in right of redemption shall be joined as party to any suit relating to mortgage.

A puisnee mortgagee also is a necessary party in such suit. The mortgagee will be seeking decree for foreclosure and hence if the plaintiff succeeds a preliminary decree will be passed for amount due and cost. If the defendant pays the amount due within 6 months. The claim of the mortgagee will come to an end and in case such payment is not so made final decree debarring the defendant to property will be passed. The court has a power to extend the time given for payment.\*\*73 Even after passing of final decree but before sale, if the amount is paid the court may on application direct the plaintiff to deliver the title deeds.

The plaintiff is also entitled to pray for preliminary decree in suit for sale. In such case also time will be given to the defendant to make payment and if no payment is made the court will pass necessary order for sale of such property.

If the sale proceeds of mortgage money are not sufficient to satisfy the debt, decree for balance amount may be passed. \*\*74

One of the rights available to the mortgagor is that of redemption and hence mortgagor can also file suit for redemption. In such case court may pass preliminary decree directing that if the amount is paid, the documents will be returned

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\*\*73 ORDER 35 RULE 2 OF CIVIL PROCEDURE CODE

\*\*74 ORDER 34 RULE 6 OF CIVIL PROCEDURE CODE

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and property re-conveyed. The court has a power to award interest which is legally recoverable. Interest may be set off against rents and profits in case of usufructory mortgage. In redemption suit final decree may be passed upon the compliance of the preliminary decree by the plaintiff.

If the court finds that mortgagee has been already paid and nothing is found due defendant may be directed to retransfer the property and pay the plaintiff the amount due. The court also has a power to direct the mortgagee to pay mesne profits derived during the time when he was in possession of the property.

The court has power to award interest which is legally recoverable and it can be pendentie lite interest and future interest. The rule is that ordinarily contractual rate be allowed unless it appears to be penal or excessive.\*\*75

If there is an existing prior mortgage property can be sold with consent of prior mortgagee or giving to him same interest in sale proceeds when property is sold free from such charge. Sale proceeds when realised will apply in the following order. :-

1. For all expenses incidental to sale.
2. Payment of amount due under prior mortgage.
3. Payment of interest on mortgage for which sale is directed.
4. Payment of principal money on such mortgage.
5. Residual payment to persons claiming and proving interest in such property.

It is open to the court to direct sale of the property free from prior mortgage with adequate protection for interest of such mortgagee. \*\*76

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\*\*75 SBI V/s. NIRU PLASTICS AIR 1984 P & H 209

\*\*76 JAYABEN OZA V/s. BAI BHANUMATI AIR 1969 GUJ.222

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If a mortgagee has obtained a decree for payment of money in satisfaction of claim under the mortgage he shall not be entitled to bring mortgage property to sale otherwise than instituting suits for enforcement of mortgage. Hence the duty is imposed on mortgagee to bring suit for such sale. \*\*77

Where a decree orders for payment of money and creates a charge on immovable property, amount may be realised by sale of property in execution of decree. Hence a decree holder is not obliged to file separately the charge and is entitled to enforce sale under order 34 rule 15 of CPC. \*\*78

## **VI**

### **CHARGES**

The Transfer of Property Act defines charges in following words :-

"Where immovable property of one person is by act of parties or operation of law made security for the payment of money to another, and the transaction does not amount to a mortgage, the later person is said to have a charge on the property.

The practical difference between charge and mortgage is that a mortgage being a right in rem is good against all subsequent transferees while a charge is good against only subsequent transferee for value with notice or a volunteer with or without notice.

The High Court of Patna explained the broad distinction between mortgage and charge as under :-

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\*\*77 KARNATAKA BANK LTD. V/s. K. SHAMMANA AIR 1972, MYSORE 321.

\*\*78 SATISH MINOCHA V/s. PNB AIR 1983 MP 42

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"The broad distinction between a mortgage and charge is that, whereas a charge only gives a right to payment out of a particular fund or property without transferring it, a mortgage is in essence a transfer of immovable property. \*\*79

Hence a charge differs from a mortgage on following aspects :-

1. Mortgage involves transfer of interest in specific immovable property while in charge there is no such transfer.
2. Charge can be created by act of parties or by operation of law, a mortgage can be created by act of parties.
3. A simple mortgage always involves a personal covenant to pay whereas a charge may not have such personal covenant.
4. A mortgage can be enforced against a transferee with or without notice charge can not be enforced against transferee without notice.
5. A mortgage can be redeemed and right of redemption is recognised by statute, in charge it means only paying off the debt.
6. A charge may be created in perpetuity, while a mortgage will always be for a limited period.
7. A mortgage secures payment of loan or debt which is always not the case with a charge.\*\*80
8. In mortgage, there may not always be a document as in case of charge.

#### **A. FIXED AND FLOATING CHARGE**

A charge may be fixed or floating. Fixed charge, right from its inception binds the company by an obligation to deal with the property only subject to such charge. It is a specific charge on a specific asset.

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\*\*79 PER DAS J IN RAJA V/s. BENI, (1922). IC PAT.P 387

\*\*80 LAW OF MORTGAGES BY RASHBEHARY GHOSE, 7<sup>TH</sup> EDITION PAGE 110.

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In words of Lord Macnaughten. \*\*81

"A specific charge fastens on ascertained and specific property or property capable of being ascertained and defined, a floating charge on the other hand is ambulatory, shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of charge within its reach and grasp."

A floating charge need not cover the whole of the property of the company but may be confined to specific portion of assets. \*\*82

The Kerala High Court has held that a floating charge is an equitable charge which does not fasten on any specific property but covers the whole of the company's property whether, it is or is not subject to fixed charge. Only upon happening of the events set out in deed of floating charge, it crystallises or becomes fixed and thereafter the assets comprised in the charge are subject to the same restrictions and affected in the same manner as under specific charge. \*\*83

According to Ramaiya, a floating charge gets crystallised i.e. gets converted into fixed charge upon happening of following events :-

- (i) When Company ceases to be a going concern and charge holder intervenes by appointing receiver.
- (ii) Upon happening of event of default as specified in document creating charge.

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\*\*81 ILLING WORTH V/s. HOULDS WORTH, 1904 AC 335 (HL)

\*\*82 A RAMAIYA, COMPANIES ACT, 14<sup>TH</sup> EDITION, VOL.I, PAGE 1134

\*\*83 UNION OF INDIA V/s. COORG ESTATES LTD. (1963) 2 (COMPL.J. 164 DB, 1426.

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- (iii) When winding up of the company commences.\*\*84

## **B. FORMALITIES FOR CREATION OF CHARGE**

A charge can be created by operation of law and in such case the provision of the statute by itself constitutes sufficient legal validity for the charge without any further act or deed. Such charge may be created in favour of the Tax Authorities for recovery of tax arrears or in favour of any other authorities or individuals as per the provisions.

A charge by act of the parties is generally created by written instrument. It is customary among the banks to obtain deed of hypothecation which creates floating charge on the property. As against this the documents like indenture of mortgage/equitable mortgage creates fixed charge on the assets of the borrower.

The Companies Act, stipulates additional formality of registration of charge when the charge is created on assets of the Company.\*\*85

The section applies to following charges :-

- (i) A charge for purpose of securing issue of debentures.
- (ii) A charge on uncalled share capital of company.
- (iii) A charge on immovable property wherever situate or interest therein.
- (iv) Charge on book debts of a company.
- (v) Charge not being a pledge on movable property of company.
- (vi) Floating charge on undertaking of the company including stock in trade.
- (vii) Charge on calls made but not paid.
- (viii) Charge on a ship or share in ship.

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\*\*84 A RAMAIYA, COMPANIES ACT, 14H EDITION, VOL. I, PAGE 1134

\*\*85 SECTION 125, COMPANIES ACT.

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- (ix) Charge on goodwill, trade mark, patent or license.

Such charge is required to be registered within a period of 30 days. Further extension of 30 days can be given by registrar. The charge if not registered is void against the registrar and against creditor of company. An equitable mortgage or charge created by deposit of title deeds also requires registration. \*\*86 The duty of charge holder is to send particulars of charge for registration alongwith relevant instrument and if charge is not registered the charge holder is not responsible. In such case charge is deemed to be registered.\*\*87

### **C. RIGHTS OF CHARGE HOLDERS**

When the charge is created by operation of law the ambit and scope of such charge is defined under the concerned statute. If the statute itself lays down some formalities it has to be complied. In case of charge by act of parties, the document creating the charge lays down the rights of charge holders. In case it is a floating charge, the events under which it can be converted into fixed charge are also narrated in the document.

To some extent, floating charge appears to be an illusory charge in the sense that the charge holder neither has the possession nor the ownership of goods. The company can deal with the property but is prevented from transferring the properties under charge. The Supreme Court in a recent case dealt with debentures secured by floating charge and held that:—

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\*\*86 CALCUTTA NATIONAL BANK LTD. V/S. RANGOON TEA CO. (1970) 40 COM CASES J65 (CAL.)

\*\*87 STATE BANK OF INDIA V/s. DEPRO FOODS LTD. (1988), 64 COM CASES 375 CR-SH)

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- (i) Debenture is usually secured only by floating charge.
- (ii) The company which creates floating charge has a right to create future securities which rank superior.
- (iii) This right may be restricted by agreement.
- (iv) In absence of evidence to the contrary, the charges will be enforced in chronological order. \*\*88

Hence the creditor holding the charge can enforce his claim and rights by resorting to the appropriate courts.

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\*\*88 N. K. MAHESHWARI V/s. UNION OF INDIA, AIR 1989 SC 2138

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