

Charge [Sec 2(16)]

“Charge” means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage. **(This section is effective from 12.09.2013)**

1. Meaning of Charge

“Charge” means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage;

Section 124 of Companies Act, 1956 dealt with the definition of the term charges, which states that “charge” includes a mortgage. The term ‘charge’ includes a term ‘lien’, which is not defined in the Act.

Lien as defined under Black’s law dictionary is as under:

“A legal rights or interest that a creditor has in until a debt or duty that it secures is satisfied, however typically a creditor does not take possession of the property on which lien has been obtained.”

In order to secure the loan the debtor creates a right in his assets or properties against the lenders which is known as, charge on the assets. A Charge may be created by executing loan agreements, hypothecation agreements, mortgage deeds and any other similar documents, which the borrowing company is required to execute in favour of the lending institutions and banks.

A charge may be ‘fixed’ or ‘floating’. When the charge is fixed, a company which has created the charge, can only deal with the property subject to the charge. But when the charge is ‘floating’ the company may, in the ordinary course of business, deal with the property in any manner until the charge gets attached.

2. Fixed Charge, Floating charge & Crystallization charge

A fixed charge is a charge which relates to specific assets of a company. A company cannot dispose the property without the consent of the charge holder.

The nature of a floating Charge is that the asset on which the charge is created is not an identified asset at the time of creation of the charge. However the nature of the asset will be specified while creating the charge. For example in case of hypothecation of stock only the nature of asset i.e. ‘stock’ will be specified on the charge document.

When the charge holder takes steps to enforce the charge, a floating charge becomes a fixed charge on the assets covered by that charge. Until a floating charge becomes a fixed charge, the company is free to deal with the property charged in any manner it deems fit. But once the floating charge crystallizes, the company cannot dispose off the charged assets without paying of the charge holder liabilities.

3. NBFCs-requirement of consent of first charge holder

RBI Press Release, refer no. dated 24-3-1998 advised that Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 have not stipulated that the debentures/ bonds have to be secured by first charge of the asset of the NBFCs in order to be excluded from the definition of the expression, 'public deposits'. In view thereof, if second charge of the asset adequately covers the debentures bonds issue, it may be regarded as secured debentures. It may, however, be ensured that:

- (1) the value of asset against which debentures are to be issued fully covers both the sanctioned limit by the bank/s and the proposed amount to be raised by issue of secured debentures bonds.
- (2) there is nothing in the documents creating the first charge which prohibits the company from granting second charge. If the documents granting first charge require the company to obtain the consent of first charge holder for creating any subsequent charge, such consent will have to be obtained.

4. Type of Charges to be registered

Section 125 of the Companies Act, 1956 specifies only specific types of charges to be registered whereas section 77 of the Companies Act, 2013 states that companies are required to register all types of charges with the registrar.

Unlike the Companies Act, 1956 every charge created within or outside India on its property or assets or of any of its undertaking whether tangible or otherwise shall be registered with the registrar. Thus every charge on assets like intellectual property etc. shall be filed and registered with the registrar of companies for example, if a vehicle is purchased on loan and hypothecation is created the same shall be filed and registered. However, in case of an asset purchased under hire purchase system, charges on the same can't be created unless the ownership on the assets is vested with the Company. It is because the company can't create a charge on an asset which doesn't have the ownership.

5. Position of Charge under UK Companies Act, 2006:

Charges are covered in Part 25, section 860 to 894 of the Act. According to section 859A of the Companies Act, 2006 (Amendment of Part 25) Regulations, 2013, "charge"

includes a mortgage and a standard security, assignation in security, and any other right in security constituted under the law of Scotland, including any heritable security, but not including a pledge.

6. Pledge, Hypothecation and Mortgage

Pledge :

Section 172 of the Indian Contract Act, 1872 defines pledge as “The bailment of goods as a security for the payment of a debt or performance of a promise” The bailor in this case is called a Pawnor and the bailee is called Pawnee

To create a valid pledge in the eyes of Law, the three important points need to be noted:

- (a) Delivery of Possession: As in bailment, in pledge too delivery of possession is required. For example, in Revenue Authority Vs Sundarsanam Pictures, AIR 1968, it was held not to be pledge because the film producer borrowed a sum of money from a financier and agreed to deliver the final prints of the film when ready. Thus, there was no delivery of the goods at the time of agreement;
- (b) Delivery is on return of a loan or promise to perform something. Therefore, if your friend gives you his Motor-cycle to go to college, it is not pledge but can be called simple bailment;
- (c) It should be in pursuance of a contract: The delivery must be done under a contract (oral or written). However, it is not necessary that delivery and loan take place at the same time. Delivery can be made even after the loan is received.

Hypothecation:

Hypothecation was not defined under Indian Law for long time and was used more on the basis of practice. However, under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (also known as SARFAESI Act, 2002) hypothecation is defined as “a charge in or upon any movable property, existing or future, created by a borrower in favour of a secured creditor without delivery of possession of the movable property to such creditor, as a security for financial assistance, and includes floating charge and crystallization into fixed charge on movable property”.

Mortgage:

Mortgage is defined in section 58 of the Transfer of Property Act, 1882. It is the transfer of an interest in specific immovable property for the purpose of securing payment of money advanced by way of loan.

Hypothecation or pledge of movable property shall also be registered. Hypothecation is only an extension of pledge wherein the creditor is permitting the debtor to retain a possession on the assets and also deal within, till the default is made by the debtor in payment of principle or interest. That means the creditor can fix the charge on the asset and can takeover the possession of asset in the event of default or winding up of the Company.

Transfer of Property Act, 1882: 'Charge' is defined in section 100 of Transfer of Property Act, 1882 as "Where immoveable property of one person is by the 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 latter person is said to have a charge on the property; and all the provisions hereinbefore contained which apply to a simple mortgage shall, so far as may be, apply to such charge.

Nothing in this section applies to the charge of a trustee on the trust-property for expenses properly incurred in the execution of his trust, and, save as otherwise expressly provided by any law for the time being in force, no charge shall be enforced against any property in the hands of a person to whom such property has been transferred for consideration and without notice of the charge.

7. Judicial Pronouncements

In a charge the right to sell the property is contractual and can be defeated by a bona fide purchaser for value without notice, whereas, in the case of a mortgage, the right to sell will consist of interest in the property being transferred to the mortgagee. In the case of a charge as well as in the case of a mortgage two elements are common. First, that there is a loan and secondly, that there is a security for the repayment of the loan. The only difference between a charge and a mortgage is that in the case of a mortgage there is transfer of interest but in the case of a charge there is no transfer of interest. The above dictum was propounded in *In Re. Calcutta National Bank Ltd. v. Rangaroon Tea Co. Ltd* [(1970) 40 Comp. Cas. 565(Cal.)]. Clause 16 of section 2 of the Act states that "charge" means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage. A charge includes a lien and also an equitable charge. As held in *[Dublin City Distillery Co. v Doherty]* [1914 AC 823] Deposit of title deeds creates a charge on land even if the depositor is not the debtor. *Re, Wallis Simmonds* [(1974 1 WLR 491)], Physical delivery of documents by the debtor to the creditor is not the only mode of deposit. There may be constructive deposit. As held in *K H. Nathan v. S. V. Maruthi Rao*, AIR [1965 SC 430]. Thus, Charge includes lien and also an equitable charge whether created or evidenced by an instrument in writing or by deposit of title deeds or by an agreement to deposit.

Contents of Geeta Saar, as extracted from ICSI Premier on Company Law, is as per notified law as on 30th September, 2016.