

Charges & Its Registration (through the Court's eyes)

Continued from Geeta Saar edition 16

10. Duty of company to register charge

Every company creating a charge within or outside India on its property or assets or any of its undertakings shall register the particulars of the charge with the Registrar within 30 days of its creation. If the company fails to register the charge within the prescribed period, then the person in whose favour the charge is created can apply to the Registrar for registration of the charge along with the instrument created for the charge. [Section 77 and 78]

11. Filing Registration

It should be observed that in view of the language of the sub-section (1) of this section, when compared to the section 125 of the Companies Act, 1956, the responsibility of the company has been enhanced from filing of charge document to ensuring the registration of the filed charge documents as well. In other words, the company is obligated to ensure the registration of the charge documents after filing with Registrar. Though the registration of the majority of the charge documents is presently under straight through process, the company should keep a watch on the same till the time the document is registered especially the documents filed after the due date.

Primarily, under section 77 of the Act, every company creating a charge shall register the particulars of charge signed by the company and its charge-holder together with the instruments creating the charge.

The important points in the Act relating to charge creation are:

- Any charge created within or outside India – on property or assets or any of the company's undertakings
- Whether tangible or otherwise, situated in or outside India
- Shall be registered. Hence all types of charge are required under the Act to be registered whether created within or outside India.

A charge created by a company is required to be registered with the Registrar within thirty days of its creation in such form and on payment of such fees as may be prescribed. According to Companies (Registration of charges) Rules, 2014 (hereinafter referred to as 'rules'), e-forms prescribed for the purpose of creating or modifying the charge is Form No.CHG-1 (for other than Debentures) or Form No.CHG-9 (for debentures including rectification).

It was held in the case of *Watson & Co. v. Spiral Globe Co* [(1902) 2 CH 209], that the date of execution of a charge is the date of creation for the purpose of computing the time as laid down in section 125 of the Companies Act, 1956 (Now section 77 of the Act), although it may take effect on a future date or on the happening of a future event.

The Companies (Amendment) Bill, 2016 proposes to insert the following new proviso after third proviso to sub-section (1) to section 77:

“Provided also that this section shall not apply to such charge as may be prescribed in consultation with Reserve Bank of India.”

12. Effect of non-registration of charge

In the case of Antifriction Bearing Corporation Limited Vs. State of Maharashtra, [(1966) (1999) 20 SCL, 373 (Bom)] it was held that charges were to be void against the liquidator or creditor unless registered. The Bombay High Court observed that filing of copy of document of charge with Registrar is not the formality but a definite legal requirement and that non-filing creates a certain legal impediment.

In the absence of registration of a charge, on date of winding up order, Official Liquidator would be justified in treating such charge holder as ordinary creditor. [Rajasthan Financial Corporation v Official Liquidator, Jaipur Spinning & Weaving Mills Ltd. (In liquidation)][(1997) 88 Comp Cas 192 (Raj)]

In the case of Industrial Credit & Investment Corporation of India Ltd. v Official Liquidator, Usha Automobile Engineering Co. Ltd. (in Liquidation)[(2000) 100 Comp Cas 150] it was held that ‘mere acceptance by a company of the terms and conditions of a loan agreement, does not amount to ‘charge’ and thus such a lender cannot be a secured creditor. But, in terms of section 125(2) of the Companies Act, 1956, such lender can receive repayment of the money as an unsecured creditor’.

Unless and until a charge is registered with the Registrar, it has no sanctity notwithstanding the fact that such charge was brought into vogue by reason of agreement inter-parties between the two creditors or by registration of guarantee bond. [A.P. State Financial Corpn. v Mopeds India Ltd.][(2005) 124 Comp Cas 833 (AP)]

In light of the expression “Notwithstanding anything contained in any other law for the time being in force” used in the sub-section (3) of this section it seems that unless the charge created is registered with the Registrar and a certificate of registration of such charge is given by the Registrar, no other law can force the liquidator or other creditor to take into account the said charge.

In other words, the liquidator or other creditor of the company need not consider the said unregistered charge against assets of the company.

Non-registration of charge - company is a going concern

The following judicial pronouncements throw light for the better understanding on the situation of non-registration of charge in case of company which is a going concern.

- (i) An English case law - Victoria Housing Estates Ltd -v- Ashpurton Estates Ltd [[1982] 3 All ER 66, [1982] 3 WLR 964- Lord Brightman] held as follows:
“It soon became established that, so long as the company was a going concern at the date of registration, the proviso did not protect, and was not intended to protect, an unsecured creditor who had lent money at a time when the charge should have been but was not registered. The reason for this was that such unsecured creditor could not have intervened to prevent payment being made to the lender whose charge was not registered (whom we will call ‘the unregistered

chargee'). Nor could such unsecured creditor have prevented the creation of a new charge, duly registered, to take the place of the unregistered charge. The proviso was intended to protect only rights acquired against, or affecting, the property comprised in the unregistered charge, in the intervening period between the date of the creation of the unregistered charge and the registration of such charge. Such persons would include a subsequent chargee of the relevant property, a creditor who has levied execution against the relevant property, and an unsecured creditor if, but only if, the company has gone into liquidation before registration is effected. Once the company has gone into liquidation, the existing unsecured creditors are interested in all the assets of the company, since the liquidator is bound by statute to distribute the net proceeds *pari-passu* among the unsecured creditors, subject to preferential debts. The assets of the company are at that stage vested in the company for the benefit of its creditors. The unsecured creditors are in the nature of cestuisque trust with beneficial interests extending to all the company's property."

- (ii) In another English Case law-Barrow Borough Transport Ltd.[(1989) 5 BCC 647 (CD)], Justice Millet precisely explained position of the law at that point of time which seems to useful to understand the issue.

"It is well established that, while the company is a going concern and its business is conducted by the directors, unsecured creditors cannot complain of the granting of an extension of time under section 404 of Companies Act, 1985 (English) and in granting in extension the court will not insert any proviso to protect their rights. This is because, as Brightman L.J. pointed out in Ashpurton, an unsecured creditor cannot intervene to prevent payment being made to the lender whose charge was not registered, nor can he prevent the creation of a new charge duly registered to take the place of the unregistered charge. However, once the company is in liquidation the situation charges radically, because existing unsecured creditors become interested in all the assets of the company. On the commencement of liquidation, a statutory scheme for distribution is imposed upon the company's assets and the unsecured creditors acquire proprietary rights under the statutory scheme. The insertion of the usual proviso to protect the accrued rights of creditors would ensure for their benefit and would make any other extending the time for registration futile. Consequently, it became an established practice that the court would exercise its discretion not to make an order extending the time for registration once liquidation has supervened, save in very special circumstances indeed which would justify the exclusion of the usual proviso."

However, in light of third proviso to sub-section (1) in case company is a going concern, said unregistered charge is registered subsequently, by theory of relation back, the original creditor can enforce the charge against the other creditors. When compared to section 125 (1) of Companies Act, 1956 to the provisions of subsection (3) of this section of the Act, situation of unregistered charge and

position of charge holder seems to be changed. The unregistered charge per se is not void against the liquidator or other creditors. However the liquidator is not required to consider the same. Status of unregistered charge is still valid as per other applicable laws like Transfer of Properties Act, 1881.

It appears that phrase “Notwithstanding anything contained in any other law for the time being in force” does not prevent the creditor in whose favour unregistered charge is created from knocking the door of court by using common law and also special law remedy available, such as Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

However, it should be noted that the rights of the secured creditor only to the extent of security for the amount are affected. He may be treated as unsecured creditor. In view of sub-section (4) of this section, though the security is not taken into account by the liquidator, non-registration of charge created does not affect any contract or obligation of the company for the repayment of the money secured by the charge.

13. Effect of decree of the Court

In the case of Official Liquidator v Suryakant Natvarlal Surati [(1986) 59 Comp Cas 147 (Bom)] it was held that if a decree was passed on an unregistered charge, before company was ordered to be wound up, section 125 of the Companies Act, 1956 (Now section 77 of the Act) would still apply in case the decree keeps the unregistered charge alive. The same was considered by Supreme Court in Indian Bank vs The Official Liquidator Chemmeens Exports (P) Ltd. & Ors [[1998] 29 CLA 425 (SC), upholding Praga Tools Ltd. vs Official Liquidator of the Bengal Engineering Co. (P) Ltd.[1984 (56) company Casas 214]. It was held that “It is also evident the section 125 applies to every charge created by the company on or after the 1st day of April, 1914. But where the charge is by operation of law or is created by an order or decree of the court, section 125 has no application.”

“In Suryakant Natvarlal Surati & Ors. vs. Kamani Bros Pvt. Ltd.[1985 (58) company Cases 121], the company created a charge under a mortgage in favour of the trustees of the Employees' Gratuity Fund. The creditors by a preliminary decree of December 3, 1977 were entitled to receive the amount secured on the property of the company; the court fixed December 8, 1988 as the date for redemption and ordered that in default of payment of the sum due by that date, the property was to be sold by public auction. On an application made on February 16, 1978, the company was ordered to be wound up by and order dated August 3, 1979. As default in payment of the decreed amount was committed, the mortgagee applied for leave of the court under Section 446 to execute the decree against the official liquidator by application dated July 10, 1981. Three contributories sought injunction against taking any further action on the ground that the charge created by the company was not registered under Section 125 of the Companies

Act, therefore, the mortgagee should be treated only as unsecured creditor. Their application was dismissed by a learned Single Judge. On appeal, speaking for the Division Bench of the Bombay High Court Justice Bharucha (as he then was) laid down, inter alia, the principle that the question of applicability of Section 125 had to be decided on the terms of the decree- whether the unregistered charge created by the mortgagor was kept alive or extinguished or replaced by an order of sale created by the decree; if upon a construction of the decree, the court found that the unregistered charge was kept alive, the provisions of Section 125 would apply and if, on the other hand, the decree extinguished the unregistered charge, the section would not apply.”[Quoted with approval in Indian Bank vs The Official liquidator Chemmeens Exports (P) Ltd. & Ors [1998] 29 CLA 425 (SC)

It was held in Praga Tools Ltd. vs Official Liquidator of Bengal Engineering Co. (P) Ltd. (in liquidation) [1984 56 CompCas 214 Cal that where a property of the company was to act as security for payment of a decretal dues, it was not a charge created by the company.

To be continued...