

Charges & Its Registration (Residual provisions of Sec 77)

Continued from Geeta Saar edition 17

13. Effect of exercise of statutory lien

It was held in *T. V. Sundaram Iyengar and Sons (P.) Ltd. v. Official Liquidator* that *[[1974] 42 Com Cas 359 (Mad)]* “Dealing with the question as to whether that section was applicable to a charge arising by operation of law, a Bench of the Oudh High Court in *Hukmichand v. Pioneer Mills Ltd.*, A.I.R. 1927 Oudh 55 held that the said section was applicable only to a charge created by the company by contract and not to a charge arising by operation of law. The same principle applies to Section 125 of Companies Act, 1956 also. Therefore, the fact that the lien claimed by the applicant-company is not registered does not disentitle the applicant company from working out its rights arising under the lien.” It should however be noted that this exercise of right is in pursuance to the statutory lien of unpaid vendor.

14. Other Important Judicial pronouncements

It was held in *Resinoid & Mica Products Ltd. Case [(1982) 3 ALL ER 677]*, that time should not be extended for registering a charge after the company had gone into liquidation, because such a step would prejudicially affect the rights of all parties which are determined on commencement of winding up.

In the case of *C.K. Siva Sankara Panicker v Kerala Financial Corpn.*(1980) 50 Comp Cas 817 (Ker)] it was held that an unsecured creditor could not challenge the validity of a charge or claim right over the property on the ground that he incurred the liability prior to its registration.

It was held in the case of *Maharashtra State Financial Corpn. v Official Liquidator, Sidhu Tyres (P) Ltd.*[(1988) 64 Comp Cas 641 (Bom)] that ‘When a charge is created by a partnership which is later converted into a company, registration is not necessary but it is obligatory on directors to bring it to notice of Registrar.’

15. Registrable charges

Clause (16) of section 2 and section 77 of the Act requires a charge to be created for every kind of interest or lien (including negative lien) on the property or assets, tangible or otherwise, of a company as security, including mortgage. The section does not list down types of charge to be registered unlike provisions of section 125 of the Companies Act, 1956.

The following is an indicative list of charges to be registered with the Registrar:—

- I. a charge created for the purpose of securing any issue of debentures or deposits;
- II. a charge on uncalled share capital of the company;
- III. a charge on any immovable property, wherever situate, or any interest therein. This includes mortgage by deposit of title deeds. [*Wallis v Simmonds (Builders) Ltd*[(1974) 1 All ER 561];

- IV. a charge on any book debt of the company. Assignment of book-debts as security is covered. [Paul and Frank Ltd v Discount Bank Overseas Ltd [(1966) 2 All ER 9221 (Ch D)]]
- V. A lien on sub freight is a charge on book-debt of the company. [Welsh Irish Ferries Ltd. [(1985) [ECLC 327 (Ch D)]]; Ladenberg & Co. v Goodwin [(1912) 3 KB 275]].
- VI. a charge, on any movable property of the company;
- VII. a floating charge on the undertaking or any property of the company including stock-in-trade;
- VIII. a charge on calls made but not paid;
- IX. a charge on a ship or any share in a ship;
- X. a charge on intangible assets, including goodwill, patent, a licence under a patent, trade mark, copyright or a license under a copyright.
- XI. a charge or assignment on insurance policies obtained by the company
- XII. all and every kind of pledge XIII. margin money, including shares, is a pledge.
- XIII. lien on shares in the company (e.g. company A has invested in shares of company B. The latter, through its Articles has lien over shares including fully paid shares for any debts due from member including trade debts. company B supplies goods to company A on credit. On such supply, lien is created and should be registered as charge)

17. Corporate Guarantee

Corporate Guarantee is used when a company agrees to guarantee repayment of borrowings together with interest and costs thereon, and such obligations of a borrower to a lender. In case the borrower fails to fulfil the terms of the agreement, the lender may press for the financial discharge from the guaranteeing company.

Section 2(16) of the Companies act, 2013 defines the term “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. Further Section 77 sub section (1) of the Act provides that it shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation:

There is a specific process by which charge is created on property of the Company viz mortgage in case of immovable property and hypothecation in case of moveable assets, etc.

Corporate Guarantee does not create any Charge per-se, unless mortgage or hypothecation etc is created on assets/undertaking. It may be noted that corporate guarantee provided by companies in the course of its business does not amount to a charge, since the guarantee given in case of a loan or a borrowing is contingent in nature and does not amount to a charge.

Corporate Guarantee is a tri-partite agreement, hence it would include a right to step into the shoes of the creditor after repaying the amount guaranteed, this additional right is not available in case of charge.

In S.T. Patil And Ors. vs Registrar Of Companies on 13 May, 1997 Equivalent citations: 1998 91 Comp Cas 578 CLB, the Hon'ble Company Law Board was of view that "Guarantees do not require registration under Section 125 of the Act. It is in this connection, reference may be made to the decision in Paul and Frank Ltd. v. Discount Bank (Overseas) Ltd. and the Board of Trade [1967] 37 Comp Cas 76 (Ch D), wherein it has been held that contracts of insurance, guarantee, indemnity, etc., do not require registration"). Further, this case law is relevant under the Companies Act, 2013

Therefore Corporate Guarantee is not required to be registered by filing of Form CHG-1. However, as a Good Corporate Governance practice it is advisable to register the Corporate Guarantee, such registration will enable banks to easily in event of default by principal borrower, execute guarantee on guaranteeing company. This registration would also operate as a constructive notice to the other lenders and any other person dealing with the company.

18. Creation of Charges with Intangible Assets

Section 77 of the Act though expressly the word intangible words not reflected by implication we can refer through the words which are mentioned in the section "whether tangible or otherwise".

The otherwise words shall be interpreted in such a manner with possible assets which are other than tangible assets. Bases for this is schedule III, relating the financial statement wherein the non-current assets were categorized along with fixed assets specified other assets relating to the intangible assets viz. Goodwill, other intangible assets, intangible assets under development was specified along with other non-current assets. Further in the notes to schedule – General Instructions for preparation of balance sheet, under the category of non-current assets, para A column IV other intangible assets are specified as follows:

- (a) Goodwill;
- (b) Brands /trademarks;
- (c) Computer software;
- (d) Mastheads and publishing titles;
- (e) Mining rights;
- (f) Copyrights, and patents and other intellectual property rights, services and operating rights;
- (g) Recipes, formulae, models, designs and prototypes;
- (h) Licences and franchise;
- (i) Others (specify nature).

For term "others" above, the reference shall be from AS-26 which deals exhaustively about the intangible assets with classification as

- (i). Legal Intangibles
- (ii). Business Intangibles

The legal intangibles are such assets like trade mark, patent, copy right, design which are backed by respective acts like Trade Mark Act, 1999; Copy Rights Act, 1957, Designs Act, 2000.

Business intangibles vary based on the industry or based on the company such are branding, customer list, franchise, lease hold rights and so on.

The above assets also are coming under purview of creation of charges on the bases of section 77.

This helps for the entrepreneurs with Intellectual ideas which can be converted as Intellectual Capital in turn intangible assets may be derived from the same. This will help the lending institutions to promote such entrepreneurship by keeping such Intangible assets under operation of charge as security by extending monies to such entrepreneurs.

However if such creation between the banker and company, the bank may be require to comply with notifications issued by the RBI from time to time. For instance, after the incident of “Kingfisher brand” which was taken as security in the earlier cases, the same is restricted by Reserve Bank of India.

19. Issue of secured debentures

Whenever a company issues secured debentures, under this section the company is required to file form CHG-9 for registration of charge created on assets of the company to secure the repayment of debentures and interest thereon. The requirement under this section is applicable both to debentures and debenture stock, if they are secured. The registration of a series of debentures protects not only debentures of that series properly issued, but also documents purporting to be debentures of that series which owing to some technical defect can only be upheld as agreements for those debentures, and it is not necessary to register these agreements separately. [Fireproof Doors Ltd [(1916) 2 Ch 142]]

The terms of issue should provide that the charges created by all the debentures of the series are to rank equally and without priority of one over another. If it is not so declared, each debenture creates a charge ranking in priority to all others issued subsequently, but postponed to all issued before it. [Lister v H Lister & Sons [(1893) 68 LT 826]] If there is a series entitled in one event to rank paripassu, but not in another event and the Registrar registers it and certifies it as a series entitled paripassu, that will not make the series rank paripassu. [Yolland & Birkett Ltd [(1908) 1 Ch 152]]

20. Deemed Registration

If particulars of charge have been sent and Registrar does not convey an objection, or does not act on the filing made, the charge is deemed to have been registered, though it has not in fact been registered. [State Bank of India v Depro Foods Ltd.][(1988) 64 Comp Cas 375 (P&H)]. – This case states that the charge is deemed to have been registered even if there is no communication from the Registrar as the duty of the charge holder is over once the form has been filed by him and he is absolved of his responsibility. However, under the provisions of section 77 of the Act, the onus is on the company to ‘register’ the charge. Thus this case is not applicable in the context of the present Act.

The reason being under section 125 of the Companies Act, 1956 filing the form was important whereas under section 77 of the Act emphasis is given for registration of charge and not mere filing.

21. Condonation of delay by Registrar

The Registrar may on an application by the company allow registration of charge within 300 days of creation or modification of charge on payment of additional fee. The Registrar may, on being satisfied that the company had sufficient cause for not filing the particulars and instrument of charge, if any, within a period of 30 days of the date of creation of the charge, allow the registration of the same after 30 days but within a period of 300 days of the date of such creation of charge or modification of charge on payment of additional fee. The application for delay shall be made in Form No.CHG-1/ Form No. CHG-9 as the case may be and supported by a declaration from the company signed by its secretary or director that such belated filing shall not adversely affect rights of any other intervening creditors of the company.

22. Application for registration of charge by the charge-holder

According to section 78 read with rule 3, where a company fails to register the charge within the period of 30 days specified in this section, the person in whose favour the charge is created may apply to the Registrar for registration of the charge along with the instrument created for the charge in Form No.CHG-1 or Form No.CHG-9 as the case may be. (For detailed commentary, please refer to section 78)

In section 78, the Companies (Amendment) Bill, 2016 proposes to substitute the words “register the charge within the period specified in section 77 “ with the words “register the charge within the period of thirty days referred to in sub-section (1) of section 77”

23. Certificate of registration of charge

Where a charge is registered, the Registrar shall issue a certificate of registration for creation of charge in Form No. CHG-2 and for modification of charge in Form No. CHG-3 respectively to the company and to the person in whose favour the charge is created.

The certificate issued by the Registrar, whether in case of registration of creation or registration of modification of charge, shall be conclusive evidence that the requirements of Chapter VI of the Act and the rules made thereunder have been complied with.

In view of third proviso, once the charge is registered including in cases of condonation under section 87, by theory of relation back, the effect of the charge shall go back to the date of creation of the charge i.e date of execution of the charge document irrespective of the order of registration of the charge with the Registrar.

24. Condonation of delay by the Central Government

If a company fails to register the charge even within the period of 300 days from the date of its creation (including acquisition of a property subject to a charge) or modification, the Registrar shall not register the same unless the delay is condoned by the Central Government under section 87 of the Act. The power under section 87 was delegated to

Regional Directors at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad and Shillong vide S.O. 1352(E) dated 21.05.2014.

25. Consequences of non-compliance of the section

As per section 86, where a company fails to comply with the provisions of this section, the company is punishable with a minimum fine of Rs. 1,00,000/- which may extend to Rs. 10,00,000/- and every officer of the company who is in default is also punishable with imprisonment for a term which may extend to 6 months or a minimum fine of Rs. 25,000/- which may extend to Rs. 1,00,000/- or with both.

As the offence by the company is punishable with fine only, it may be compounded by the Tribunal as per the provisions of the clause (a) of sub-section (1) of section 441. Offence by officer of the company may be compounded with the permission of the Special Court as per the provisions of clause (a) of sub-section (6) of section 441.

26. Registration under the SARFAESI Act, 2002

The registration of securitisation, asset reconstruction or creation of security interest by the securitisation company or reconstruction company or the secured creditor, as the case may be, with the Central Registry as per the provisions of section 23 of the said Act is an additional compliance. As per the provisions of sub-section 4 of section 20 of the said Act, such registration with Central Registry is not in derogation of the provisions of the Act and has no effect on priority and validity of the charge.

Concluded