

Charge On Movable Properties

A charge on movable properties can be created in the following five different ways:

- Pledge**
- Hypothecation**
- Assignment**
- Banker's Lien**
- Set-off.**

Pledge: According to Section 172 of the Indian Contract Act, 1872: "Pledge is a contract where, by way of deposit of goods a security for a debt is created and the right to property vests in the pawnee so far as it is necessary to secure the debt." In other words, a pledge arises when the lender or the pledgee takes possession of either the goods or bearer securities for extending a credit facility to the borrower or the pledgor. The pledgee can retain the possession of the goods until the pledgor repays the entire debt amount and in case of a default, the pledgee has the right to sell the goods in his possession and adjust its proceeds towards the amount due.

The delivery of goods in a pledge can be either by actual delivery or constructive delivery. In the former case, the pledgor hands over the physical possession of the goods to the pledgee. In the case of constructive delivery, there is a symbolic delivery of goods, for example, the pledgee may be given possession of the key to the store in which the pledged goods are present or there may be a transfer of the bill of lading. A bank usually considers such type of lending.

While lending against pledge, the bank always maintains a margin between the value of the goods and the amount of credit allowed. For instance, if the bank is extending a credit of Rs. 1 lakh against the pledge of goods, then the value of the goods pledged

should be more than Rs. 1 lakh. Further, in a pledge transaction, the underlying goods are usually either the raw materials or the work-in-process or the finished goods. The borrower in the regular course of business would require finance for these activities. In such a case, the borrower needs to take prior approval from the bank to withdraw any goods that are pledged with the bank since the goods will be in the custody of the bank. In addition to this, the borrower will also have to submit statements to the bank for further additions or withdrawals made to these goods that represent the pledge transactions.

Precaution must be taken to ensure that the securities pledged are stored properly so that the value of the security does not get reduced due to any deterioration in the quality.

Hypothecation: Hypothecation is a way of creating a charge against the security of movable assets, which is much similar to pledge. However, pledge is a charge, which is defined by law whereas it is not so in the case of hypothecation. In case of pledge, the assets are in the custody of the lender, real or constructive, whereas in the case of hypothecation the assets are in the custody of the borrower.

Hypothecation is to be registered under Section 125 of the Indian Companies Act, 1956 when the hypothecator is a limited company, whereas no such provision exists in case of charges by way of pledge.

A major demerit of hypothecation is that the goods are not kept under the lock and key of the banker. The borrower, however, will have to submit a stock statement at prescribed intervals as per terms of sanction to the bank. In addition to the fact that the bank does not have the physical possession of the goods under hypothecation, the fact remains that no statutory status is given to a hypothecation transaction. In this regard, it is, however, to be noted that hypothecation has a close link to floating charge. While there is no law governing the hypothecation of goods, Section 125(4)(t) of the Companies Act, 1956 that refers to the Floating Charge, may be considered as related to

hypothecation. According to this Section, floating charge creates an immediate charge on the property charged which however allows the borrower to use the property for its business just as in the case of hypothecation. This makes the charge in a hypothecation transaction similar to the type of floating charge.

Assignment: Assignment is a charge in case of an "Actionable Claim" which is defined under Section 3 of the Transfer of Property Act, 1882 as follows: "Actionable claim means a claim to any debt, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of movable property, or to any beneficial interest in movable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent." Assignment is a charge created on assets such as receivables, debtors, etc. For example, policyholders can take a loan against the Life Insurance Policy from a bank. In such cases, the policyholder assigns the LIC policy to the bank. If the bank finances a firm against book debts, then such book debts are assigned to the bank.

While obtaining documents wherein assignment of security is required, the fact of such assignment must be noted in the security. For instance, in the case of assignment of LIC policy, this fact is to be mentioned in the policy itself, which shall be acknowledged by the LIC.

Banker's Lien: This is a general lien and is defined under Section [7] of the Indian Contract Act, 1872 as follows: "Bankers, factors, wharfingers, attorneys and policy-brokers, may, in the absence of contract to the contrary, retain as a security for a general balance of account, any goods bailed to them; but no other persons have a right as a security for such a balance, goods bailed to them, unless there is an express contract to that effect."

Thus, a bank has the right to retain all forms of securities or negotiable instruments deposited by or on behalf of the debtor in the ordinary course of its banking business and use the proceeds

of the same towards adjusting the debt obligation of the borrower in case of default by borrower.

Set-off: Set-off can be treated as the right of lien, the only distinction being that lien relates to goods or any other property on which the bank as a creditor has a right, while a set-off is a lien on any amount of the debtor that is due from the bank. Simply put, set-off is a legal right by which the bank as a creditor is allowed to use its own debt obligation (i.e., amount that the bank is allowed to set-off against the repayment of the credit facility it had offered to the debtor). Such right exists when the amount of the debts are certain, when the parties are the same and when there is no contract, expressed or implied to the contrary by virtue of Indian Civil Procedure Code.

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