BANKING LAWS COMMITTEE

(GOVERNMENT OF INDIA)

REPORT

ON

PERSONAL PROPERTY SECURITY LAW

1977

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बैंकिंग विधि समिति
BANKING LAWS COMMITTEE

(भारत सरकार)
(GOVERNMENT OF INDIA)

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21st October 1977

Dear Shri Patel,

Report on Personal Property Security Law

It is my pleasure to submit herewith the Banking Laws Committee's Report on Personal Property Security Law. This covers the law relating to loans and advances by banks, hire-purchase and other financing institutions and others against stock in trade, accounts receivables, other types of goods like machinery and fixtures, crops, documents of title to goods and instruments. Though Sir Rashbehary Ghose and several expert bodies have been pleading for expeditious enactment of a statutory scheme to cover this area, this branch of the law has not so far been covered by codified law.

2. In the light of the research and review referred to in brief in the "Introduction to this Report", the Committee has suggested *inter-alia* a comprehensive statutory scheme as set out in the draft Bill given in Part IV of this Report. Apart from providing appropriate solutions to the difficulties faced by institutional lending agencies, the statutory scheme the Committee is suggesting also aims to provide such in-built incentives as a statutory framework could, to facilitate extension of purpose and production oriented credit by banks and other financing institutions, and more particularly to such credit to priority sectors and non-corporate borrowers. Having regard to its importance, the Committee hopes that Government would be taking suitable expeditious action in this matter.

With warm personal regards,

Yours sincerely,

(P. V. RAJAMANNAR)

Hon'ble Shri H. M. Patel,
Finance Minister,
Government of India,
North Block,
NEW DELHI.

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PART I

PRESENT STATE OF THE LAW AND THE OUTLINE FOR THE NEW BASIS


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CHAPTER 1

INTRODUCTION TO THE REPORT

The Banking Laws Committee has been constituted by the Government of India[1] as a One-man Committee under the chairmanship of Dr. P. V. Rajamannar, retired Chief Justice of the High Court of Madras, to review:

(1) Codification of commercial laws affecting banking.

(2) Law relating to negotiable instruments and codification of practices and usages relating to indigenous negotiable instruments.

(3) Laws relating to—

(a) bank deposits and collections ;

(b) documents of title to goods ;

(c) loans and advances generally with particular reference to banks and financial institutions ;

(d) guarantees issued by banks ; and

(e) letters of credit, unsecured advances and special provisions relating to recovery of loans.

GENESIS AND CONSTITUTION

1.1.2 On the matters under reference to the Banking Laws Committee, the several areas requiring review were earlier indicated by the Banking Commission (1972) and its Study Group which reviewed legislation affecting banking. Government of India facilitated this review by appointing the Chairman of that Study Group as the Chairman of the Banking Laws Committee and by arranging to spare for the Committee the services of the Convener-Member of that Study Group, Shri R. Krishnan (Deputy Legal Adviser, Reserve Bank of India), who has been appointed as the Secretary to the Committee.

[1]By their Resolution No. F. 10(5)-BC/71, dated 24th November, 1972.

ORGANISATIONAL SET-UP

1.1.3 As desired by the Government of India, the Reserve Bank of India has been assisting the Banking Laws Committee on the lines of its assistance to the Banking Commission. The Special Cell of the Reserve Bank, headed by the Secretary, has been providing the secretariat for the Banking Laws Committee.

REPORTS ON THE SUBJECTS

1.1.4 Having regard to the necessity in its review for an intensive study, the consideration of the experts' views, organisation of research, the collection, tabulation and analysis of the required material the processing of the views and suggestions, and the time these efforts necessarily consume, the Committee decided to submit to Government separate reports on the several subjects comprised in its Terms of Reference. Pursuant to this decision, the Committee's Report on the Negotiable Instruments Law was submitted to the Government in 1975.[1]

1.1.5 Now the Committee is submitting its separate Reports on the review of our Personal Property Security Law and our Real Property Security Law. The work relating to the review of these branches of laws has proceeded concurrently, since both these reviews are complementary to each other as they cover practically the whole gamut of the law relating to secured advances. In this Report, the Committee reviews our personal property security law.

PRESENT POSITION

1.1.6 Our personal property security law has remained till now substantially outside the purview of the codified law. As a consequence, for decisions concerning this branch of the law the courts of our country have been applying the English common law rules in the view that they may be in accordance with justice, equity and good conscience.

1.1.7 Developments within our country have been pointing out the difficulties inherent in the application of the common law principles to decide questions concerning credit and security against different forms of assets like stock in trade, accounts receivables, fixtures like machinery, crops, documents of title to goods, actionable claims and other forms of contract rights, under the multifarious forms of security devices now employed by banks and other financing institutions and styled as hypothecation agreements, pledge documents, mortgages of movable property, trust receipts, etc., with reference to the assets of both corporate and non-corporate constituents.

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[1]Banking Laws Committee's Report on Negotiable Instruments Law (PED. 236 published by the Controller of Publications, Delhi-110 006).

POSITION IN OTHER COUNTRIES

1.1.8 In this branch of the law, not only in our country but also in the U.K., the U.S.A., Canada, Australia and other common law countries the fact has now been recognised that the common law principles are not conducive to the development of an adequate legal frame-work to decide questions relating to personal property security law. This was also recognised by the Committee on Consumer Credit appointed by the U.K. Government under the chairmanship of Lord Crowther.

WORK OF THE STUDY GROUP

1.1.9 The Study Group of the Banking Commission referred to earliest tried to analyse several of the areas where difficulties were experienced under the various forms of security devices adopted by banks and other financing institutions. This Committee has had the benefit of the views on the questionnaire of the Study Group circulated at the Committee's instance to all commercial banks, selected co-operative banks and other financial institutions and others and also to selected experts and institutions outside the country.

PROJECT STUDY ON PERSONAL PROPERTY SECURITY LAW (PPSL)

1.1.10 The replies, including the opinions of foreign experts, furnished to the Committee made it abundantly clear that we require a simple, rational, modern and comprehensive statute which would clear *inter alia* the several difficulties now faced by banks pursuant to the application of archaic common law rules with reference to the different forms of security devices. In the light of the models developed in other common law countries, the Committee felt the need for an intensive project study which could suggest the basic frame-work for such a comprehensive legislation.

1.1.11 For this purpose, with the approval of the Government of India, the Banking Laws Committee sponsored *the project study on personal property security law* to promote an indepth study of the several problems relating to our personal property security law to evolve a statutory scheme to regulate transactions secured against personal property and consumer credit, which would *inter alia* provide the appropriate solutions to the problems.

PPSL PROJECT TEAM

1.1.12 The project study on personal property security law was conducted by a team of experts comprising Shri R. Krishnan, Secretary, Banking Laws Committee, Dr. K. B. Rohatgi, Director, South

Delhi Campus of the University of Delhi, Dr. K. Ponnuswami, Reader, Faculty of Law, University of Delhi, and Dr. B. Sivaramayya, Reader, Faculty of Law, University of Delhi.

1.1.13 The Project Report (Annexure 7) contains the several recommendations made by the Project Team in the form of a draft Bill. The Project Team finalised its report on 31st May 1976.

1.1.14 On 24th June, 1976 the Committee discussed at Bangalore with some leading bankers and the members of the Project Team the broad features of the statutory scheme suggested by the Project Team.

COMMENTS ON PPSL PROJECT SCHEME

1.1.15 In order to enable a more careful review and assessment of the suggested scheme and to enable associations of bankers, representative bodies of industry, trade and commerce and others to study the same, the Project Report was circulated to all commercial banks, selected co-operative banks, the Indian Banks Association (IBA), the Federation of Indian Chambers of Commerce and Industry (FICCI), the Indian Merchants Chamber, the hire-purchase financing institutions and their associations, etc., and also to individual experts including some foreign experts (Annexure 8). This has helped the Committee to elicit the reaction of the several bodies and experts to the scheme and in the light thereof and its own further studies, to modify the scheme appropriately.

VIEWS ON PPSL PROJECT SCHEME

1.1.16 Quite useful comments were received from many Chairmen and Chief Executive Officers of commercial banks, other public financeing institutions like the Industrial Development Bank of India, Industrial Finance Corporation of India, State Financial Corporations, etc., representative bodies of industry, trade and commerce, and a number of experts. Annexure 9 gives the list of institutions and individuals who have offered their comments.

FICCI STUDY TEAM

1.1.17 The FICCI had appointed a Study Team to consider the several questions raised, and Shri R. Krishnan, the Secretary to the Committee, participated in the deliberations of the Study Team and helped in their assessment of the working of our present personal property security law and its impact on the industry, commerce and trade. Subsequently, the FICCI engaged the services of an eminent banker, Shri T. D. Kansara, to study the features of the scheme, and have made available to the Committee his expert comments.

SPECIAL STUDY BY THE GRINDLAYS BANK LTD.

1.1.18 Several commercial banks critically examined the provisions of the scheme and helped the Committee with their valuable comments. In particular, the comments offered by Mr. K. Warner, Regional Director, South Asia, of the Grindlays Bank Ltd., who had gone into the provisions of the scheme, led to a series of further discussions with the representatives of the Grindlays Bank Ltd. and the Secretary to the Committee ; these discussions helped to improve the provisions of the scheme.

HIRE-PURCHASE FINANCING ASSOCIATIONS

1.1.19 The scheme suggested came in for critical examination by hire-purchase financing institutions represented by the Federation of Indian Hire-Purchase Associations. This Federation and its Legal Affairs Committee came forward with a number of constructive suggestions for the improvement of the scheme and placed before this Committee certain practical difficulties which the hire-purchase financing companies may face when hire-purchase credit is regarded in its real character, i.e., as a form of instalment credit for purchase money. Of them, Shri T. S. Santhanam, Managing Director of Messrs. T. V. S. & Sons Ltd., Madras, Shri Ved Prakash, the President, and Shri S. S. Khera, the Vice-President of the Federation, and Shri P. T. Krishnan and Shri G. K. Raman, the past and the present Chairmen of the Federation's Legal Affairs Committee, took a leading part in studying the scheme critically and placing before this Committee their detailed comments. The discussions with them have considerably helped this Committee in making appropriate recommendations with a view to ensure that hire-purchase financing companies play effectively their role as instalment credit providers, and more particularly, in the extension of such credit for acquisition of motor vehicles.

FOREIGN EXPERTS

1.1.20 Quite a number of foreign experts readily spared their valuable time and gave their appraisal of the statutory scheme suggested by the Project Team. Prof. R. M. Goode, the Crowther Committee member and an authority on the subject in the U.K., Mr. Maurice Megrah, Q.C., Prof. R. C. C. Cuming, Consultant to the Law Reforms Commission of Saskatchewan on the personal property security law project, Mr. R. J. Ellicott, Attorney-General of Australia, and his Department, Mr. Haddon Storey, Attorney-General of the State of Victoria, Mr. Walter D. Malcolm and Mr. Robert Haydock, Jr. of Messrs. Bingham, Dana and Gould, Boston, U.S.A., have given valuable and useful comments on the PPSL Project Report (Annexure 10).

BANKING COMMISSION MEMBERS

1.1.21 Shri R. G. Saraiya, Chairman, and Shri N. Ramanand Rao, Member, Banking Commission (1972), carefully went through the scheme and in a series of meetings with the Secretary to the Committee made several constructive suggestions to strengthen the scheme, while Dr. Bhabatosh Datta and Shri V. G. Pendharkar, Member and Member-Secretary respectively of that Commission, have also been good enough to give their general comments.

APPRAISAL OF THE COMMENTS

1.1.22 The numerous comments on the suggested statutory scheme received from banks, representative bodies of industry, commerce and trade, foreign and Indian experts, hire-purchase financing associations and their representatives, and several others revealed the general appreciation of the basic frame-work of the suggested scheme. But the comments also raised numerous specific points with reference to certain assumed or sometimes genuine difficulties which may be faced consequent on the introduction of the suggested statutory scheme. These comments required careful analysis and study.

ANALYSIS BY THE PROJECT STUDY TO REVIEW CREDIT LAWS

1.1.23 As part of the project study to review credit laws affecting banking, which was sponsored by the Committee with the support of the Reserve Bank and in which the Banking Laws Committee, the Indian Banks Association and the National Institute of Bank Management participated, the analysis and appraisal of the aforesaid comments were taken up. On behalf of these bodies, this work was undertaken by an expert team comprising of Shri R. Krishnan, Secretary to the Committee, Shri R. M. Halasyam, Legal Adviser of the Indian Banks Association, and Shri S. R. Bhise, Officer on Special Duty, National Institute of Bank Management. The expert team also had several discussions with the concerned persons and later with the Committee. These representatives gave the Committee the benefit of their analysis and also made concrete suggestions for amendments to the scheme *inter alia* in order to take care of all valid points made by the comments.

FINAL ANALYSIS

1.1.24 In preparing this Report and in recommending the statutory scheme, the Committee has taken into account the several difficulties faced by banks and others on the several aspects of our personal property security law including those pointed out earlier by the

Study Group of the Banking Commission, the numerous comments and views received with reference to the questionnaire issued by the said Study Group, the data collected, the comments made by individual banks, Indian Banks Association, FICCI, representative bodies of industry, trade and commerce, the Report of the Project Study on PPSL, and the work done by the Project Study on the review of credit laws. In addition to the aforesaid research and studies, the Committee has also taken into account the several developments in the field of personal property security law in the U.K., the U.S.A., Canada and Australia.

1.1.25 Thus, the Committee has fully considered the reaction, so far as they were made articulate, of the representative bodies of the widest possible segment of the population and of the experts that may be directly concerned with the working of the scheme. The Committee has endeavoured to safeguard adequately the interests of all consistent with the paramount needs of public interest and the necessity for banks and other financing institutions being adequately facilitated to function in their role as catalysers of our country's socio-economic development.

EMERGING GENERAL POSITION

1.1.26 In the light of the work and analysis detailed above, we may set out thus the general position that emerges as a result of this review.

1.1.27 Our credit-security law has become antiquated since it does not recognise the functional role of the security but lays undue emphasis on the form, and ignores the substance, of the transaction. It has to be made rational and modern to facilitate intelligent financial planning. In the context of the developmental role banks and other public financing institutions are required to play for implementing the socio-economic reforms and for catalysing economic development, the necessity in our country for a rational scheme of legislation has become urgent. When the security-oriented approach is being discarded by banks and other public financing institutions and the availability of credit is determined in accordance with credit planning to suit our national priorities and purposes, our law requires to be reshaped with a view to reflect the substance of the arrangements and to give such incentives as a legal framework possibly could for the implementation of the national priorities.

LEGAL REFORM OVERDUE

1.1.28 With reference to several branches of the PPSL, the necessity for adequately reforming our law had been stressed for the past several decades. Sir Rashbehary Ghose had in his Tagore Law Lectures

(1875) regretted the absence of legislation on the subject of hypothecation of movables and hoped that some day the Indian legislature would have leisure to take up this question on hand. The Indian Central Banking Enquiry Committee (1931) had drawn attention to the generally defective nature of our credit-security law, and particularly with reference to trust receipts. In 1952, the National City Bank of New York had submitted a Memorandum (Annexure 1) to the Reserve Bank Governor on the necessity for a trust receipt legislation in India. The questionnaire of the Banking Commission's Law Study Group (Annexure 2) has also drawn attention to several of the features where the present state of our personal property security law merits review. Recent decisions of courts have also confirmed the necessity in this field for a comprehensive statutory scheme.

NECESSITY FOR A REVIEW RE. CONSUMER CREDIT

1.1.29 While in this Report we are considering all the aspects relating to commercial and business credit with reference to the different types of available personal property which may be offered as security to the institutional and other lenders, we have also to draw the Government's attention to the necessity for a comprehensive review of our law relating to consumer credit. Such a review was contemplated by this Committee when the Project Study on Personal Property Security Law was originally conceived. However, the magnitude of the review relating to the general commercial and business aspects of the Projects Study precluded the review of the law relating to consumer credit also being taken up simultaneously. Our Hire-Purchase Act, 1972 (which is yet to come into force and with reference to which in certain respect we are suggesting some amendments) and our money-lending legislation deal with the basic statutory framework now in force in our country in the field of consumer credit. Both these legislations have become inappropriate with reference to business credit. The Bombay Shroffs' Association has submitted a memorandum to this Committee on the impact of the money-lending legislation on bona fide commercial and trade transactions (Annexure 11). Before going into the review of our personal property security law in general, we may also at this stage stress the necessity for an appropriate review of our law relating to consumer credit.

FORMAT OF THE REPORT

1.1.30 In Chapter 2 of this Part we review the position of the law in general, particularly, with reference to the major forms of security devices adopted by banks and other public financing institutions. In Chapter 3 of this Part we deal with instalment credit for purchase money, which takes the shape of "hypothecation" when it is given by banks, and the form of "hire-purchase" when it is extended by

hire-purchase financing institutions. In Chapter 4 of this Part we point out the need for a statutory scheme based on the functional approach; we also indicate the main features for the new scheme and state the necessity for employing neutral terms which will truly reflect the substance of the transaction.

1.1.31 Part II of this Report contains a security-wise analysis and also deals with the provisions and the machinery necessary for registration of security interests in personal property and the legal framework that should be available when it becomes necessary to realise the security. In Part III of this Report we give the summary of our conclusions and recommendations, and in Part IV the draft Bill (with Notes on Clauses) we are recommending for the Government's consideration.

1.1.32 The annexures as set out in the table of contents are given at the end. The annexures not referred to above are the list of institutions and individuals to whom the questionnaire of the Study Group was sent (Annexure 3), the list of institutions and individuals who replied to the questionnaire (Annexure 4). The replies of Mr. Carl W. Funk, Counsel to the Permanent Editorial Board of the Uniform Commercial Code (ALI-ABA), U.S.A., and those of Mr. Maurice Megrah, Q.C., of the U.K., are given as Annexures 5 and 6 respectively.

ACKNOWLEDGEMENTS

1.1.33 The Committee would like to acknowledge with thanks the assistance and help it has received from the Government of India, the State Governments, the Reserve Bank of India, the Indian Banks Association, the National Institute of Bank Management, the FICCI, the Law Commission of India, the commercial and co-operative banks, term-lending institutions, and various other bodies representing industry, trade, commerce and law. They have all responded to the Committee's request and assisted it in various ways. The Committee would like to thank also all senior and middle level officers of banks and other individuals who, in response to special request, answered the questionnaire and gave their views.

1.1.34 The Committee would also like to specially thank all the members of the Project Study on Personal Property Security Law and of the Project Study for the review of credit laws affecting banking. While Shri R. Krishnan, Secretary to the Committee, was involved in both the Projects, Dr. K. B. Rohatgi, Dr. K. Ponnuswami and Dr. B. Sivaramayya of the University of Delhi were involved in the first Project and in the second Project Shri R. M. Halasyam, Legal Adviser, IBA, and Shri S. R. Bhise of the NIBM were actively associated.

1.1.35 Several international bodies and foreign experts have given assistance to the Committee in obtaining valuable information and views on comparable laws and practices in other countries. Special mention should also be made of the help received from Mr. Willem Vis, Chief, UNCITRAL, the Secretariat of the International Chamber of Commerce, the American Law Institute, the National Conference of Commissioners on Uniform State Laws of the U.S.A., the Canadian Bankers Association, the Law Reform Commissions of the Canadian States, the Federal and the State Attorneys-General and their Departments in Australia, the Bank of England, the Bank of Canada and the Reserve Bank of Australia.

1.1.36 The Committee would also like to specially thank Prof. R. M. Goode and Mr. Maurice Megrah, Q.C., of the U.K., Prof. Ronald C. C. Cuming and Prof. Jacob S. Ziegel of Canada, Mr. R. J. Ellicott, Australian Federal Attorney-General, Mr. J. H. Greenwell of his Department, Mr. Haddon Storey, Attorney-General, Victoria and Mr. R. Glenister, Secretary, Law Department, Victoria, Mr. Carl W. Funk, Mr. Walter D. Malcolm and Mr. Robert Haydock. Jr. (of Bingham, Dana & Gould, Boston) of the U.S.A., for their valuable views and comments on several matters of vital interest to the Committee in its work. Mr. B. S. Wheble of SITPRO, London, Mr. M. L. Saunders of the Attorney-General's Chambers London, Mr. M. N. Carmel of the British Bankers Association, Mr. Mc K. Vann of the Department of Consumer Protection, U.K. Mr. J. F. Riegert, Mr. G. H. H. Read and Miss Mary E. Duncan of the Canadian Bankers Association, Mr. Paul A. Wolkin of the American Law Institute and several others have helped the Committee in obtaining valuable material and literature.

1.1.37 The Reports on the Research Project on Credit and Security sponsored by the Asian Development Bank and the Law Association for Asia and Western Pacific, authored by Prof. David E. Allan, Dr. Mary Elizabeth Hiscock and Prof. Derek Roebuck, have provided, expected, the sort of basis on which each country could examine its own problems and work out its own solutions in its review of the credit-security law. The Committee acknowledges the assistance it has derived from this Project Study.

1.1.38 The Chairman of the Committee wishes to record his high praise for the work of the Secretary to the Committee, Shri R. Krishnan, who has organised and carried out the research and studies for the Committee's review of this subject, has taken the leading part both in the Project Study on Personal Property Security Law and in the Project Study of the review of credit laws, and has attended to the drafting of this Report. His in-depth study and research and his

expert and sound knowledge of economics and of banking and commercial laws and practices in India and in other countries have greatly helped the Committee in finalising this Report.

1.1.39 In his work the Secretary has been ably assisted by the officials (vide Annexure 12) and the other staff of the Reserve Bank's Cell who have put in hard work with cheer and have helped in the successful completion of the efforts of the Committee. Shri N. K. Ramaswami, Private Secretary to the Chairman, and Shri V. Vembu, Personal Assistant, have attended to their work with commendable efficiency.

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CHAPTER 2

THE PRESENT STATE OF OUR PERSONAL PROPERTY SECURITY LAW—GENERAL

Lending against movable assets without taking possession of the secured property is a function undertaken in our country mainly by banks and other financing institutions including hire-purchase financing institutions. Banks and other financing institutions obtain security interests in the movable assets of the borrower by taking security agreements which are now variously described as hypothecation, pledge, trust receipt, etc. Hire-purchase financing institutions employ different phraseology as "owner", "hirer", etc. in their hire-purchase agreements, though the transaction is in substance only a secured transaction. We refer as personal property security law that branch of our credit-security law which deals with all forms of lending against movable assets including fixtures like machinery.

CODIFICATION SUGGESTED BY BANKING COMMISSION

1.2.2 The Banking Commission (1972) has pointed out that there is no law as such in India dealing with lending against charge on movable assets and that the usual documents obtained by banks do not help to decide rationally and readily their effect and in the reconciliation of the claims of third parties on the secured assets[1]. There is no statutory scheme now which clearly states the mutual rights of banks and their customers borrowing against personal property. There are also no adequate provisions for ascertaining and reconciling the claims of third parties who may be dealing with the secured asset with or without notice of a bank's claim.

REFORM NECESSARY TO FURTHER CREDIT POLICY

1.2.3 Ambiguity in personal property security law not only affects the spread and operational efficiency of banks and other financing institutions but also adds to the cost of credit. It makes banks insist on other kinds of security like land, buildings, third party guarantee, etc. It curbs banks in taking to innovative credit schemes and in catering effectively to the credit needs of the non-corporate

[1]Banking Commission's Report (1972), para. 21.51.

sector, particularly, the weaker sections, small entrepreneurs and small businessmen who are not in a position to offer as security immovable property or third party guarantee.

IMPORTANCE UNDER THE GOVERNMENT'S NEW ECONOMIC PROGRAMME

1.2.4 In order to quicken the pace of implementation of the new economic programme of the Government aimed to maximise employment and yield optimum socio-economic benefits, the necessity is obvious for a statutory scheme which will take care of all the existing defects in our personal property security law. Such a scheme should facilitate the shift, aimed by Government from capital-intensive to employment-oriented technologies which are conducive to decentralised operation of low-energy systems. It has, therefore, been stated in the economic programme of the Government that such a policy will also have its implications in the field of credit and marketing. Hence, the scheme should facilitate banks and other financing institutions lending for productive purposes to small businessmen and to other priority sectors under our credit policy. This should also help to reduce the cost of credit.

OUTLINE OF PRESENT DEFECTS

1.2.5 The absence of a statutory scheme which would help to decide rationally and readily the rights of parties to a secured transaction, the undue emphasis on the form of the transaction rather than on its substance in deciding the rights of parties, the inadequate machinery for registration of charges over moveables and most essentially the failure of our credit-security law to recognise and encourage, as in certain developed countries, credit for productive purposes, are the major handicaps in the way of banks and other financing institutions making faster strides than they are now in a position to do, in the fulfilment of the country's socio-economic objectives.

MANY DEFECTS COMMON TO COMMON LAW COUNTRIES

1.2.6 In the absence of statute, the principles of Common Law as understood and interpreted in the U.K. have been applied in our country by courts on grounds of justice, equity and good conscience.[1] Hence, it is natural that many of the defects, which we notice in the realm of personal property security law, are not peculiar to our country alone and that they are common to the countries which have adopted by and large the principles of Common Law.

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[1]For the manner and scope of the application of our Common Law, please see M. C. Setalvad's Hamlyn Lectures (1960) on the "Common Law in India", Stevens & Sons Ltd., London.

1.2.7 This is seen clearly from what a leading U.K. based commercial bank has submitted to this Committee:

> "In a developing country such as India banking and financial institutions have undoubtedly a vital role to play for rapid economic development of the country. However, the experience of these institutions over the years in securing their interest by recourse to common law has been none too happy. Therefore, there is a crying need for legislation in this field.
>
> Despite the common law remedies available to the banks and financial institutions for securing their interests against those entrepreneurs who resort to institutional credit, *their is a consensus among these institutions that the existing state of the law does not promote the effective utilisation of personal property as security for credit.*"
>
> (emphasis added)

DEFECTS NOTICED SINCE THE DAYS OF THE INDIAN CENTRAL BANKING ENQUIRY COMMITTEE

1.2.8 Though it is only now we are making a comprehensive assessment of the defects in all the branches of our personal property security law, these defects have been pointed out in our country, in one branch or another, since the days of the Central Banking Enquiry Committee (1931). Various governmental bodies have been urging appropriate reforms to the law relating to particular types of transactions relating to lending against moveables.

1.2.9 While pointing out the need for reform in the field of personal property security law of our country, the Banking Commission (1972) has referred to the unsatisfactory position of the law relating to hypothecation, trust receipts and fixtures. That Commission has also stressed the necessity for a suitable machinery for registration of charges on movable assets and has recommended that the feasibility of creating a suitable machinery with a simple and less expensive procedure for verification, has to be examined from legal as well as practical angles. That Commission has also noted that in the light of the developments in the U.K. and the U.S.A., our hire-purchase legislation would require further consideration.[1]

FORMS OF SECURITY DEVICES

1.2.10 We shall make here a brief mention of the main forms of security agreements that are being used by banks and other financing institutions and refer to some of the difficulties encountered with

[1]Banking Commission's Report (1972), paras. 21.51 to 21.53 and 21.55.

reference to them, which have led to a shake up of the traditional understanding of bankers. In this illustrative manner, we shall refer to (i) "pledge" and "mortgage" transactions, (ii) obtaining charges over fixtures and accessions, (iii) hypothecation agreements obtained by banks and other financing institutions, (iv) instalment credit agreements in the form of hire-purchase and (v) trust receipt advances. Then we shall consider how in order to enable banks and other financing institutions to fulfil effectively the new economic programme of the Government, our credit-security law requires to be modernised to recognise the economic function of security.

A. "PLEDGE" AND "MORTGAGE"

1.2.11 Until the early 19th century the only security devices known to Common Law were the mortgage of real property and the pledge of chattels.[1] Originally, the transfer of an interest in personal property without delivery of possession was looked on as being, in essence, a fraudulent conveyance, invalid against creditors and purchasers.

IMPACT OF INDUSTRIAL REVOLUTION

1.2.12 The principal cause which ultimately led to the gradual disappearance of the rule that as against personal property, only a possessory security interest should be encouraged, was the industrial revolution which brought about an unprecedented and rapid expansion of industrial facilities and created an unprecedented demand for credit. As industrialisation progressed, personal, rather than real, property came to be the principal repository of wealth. The story of how the equipment and the stock in trade came to be available as security, as Gilmore says, is essentially the story of personal property security law in the 19th century.[2]

VAGUE DISTINCTION BETWEEN PLEDGE AND MORTGAGE

1.2.13 As Gilmore has pointed out, the courts have never devised a workable rule for making the distinction between pledge and mortgage on which so many important issues turn. "Perhaps a workable rule was the last thing that was wanted ; so long as the grounds on which the distinction was made remained impenetrably obscure, there was room for judicial manoeuver which may have led to doing rough justice between the parties at, to be sure, some harm to the idea of

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[1]Grant Gilmore, "Security Interests in Personal Property", (1965), Vol. I, Little, Brown and Company, p. 24.

[2]*Ibid.*, pp. 24-25.

commercial certainty."[1] Verbal solution to the pledge-mortgage question was the always reiterated statement that the mortgagee got title or an estate whereas the pledgee got merely possession with a right to foreclose on default. The form of the transaction was observed by courts and they were holding that while an absolute grant in a secured transaction must be a mortgage, any other agreement for security must be a pledge. But there was no such convenient rule and the difficulty was being felt, particularly, in the cases of choses in action like shares or stock. Gilmore has said that the whole matter floats nebulously in the fog, "the intent of the parties" out of which courts are so apt to evoke what they most want. No wonder, the experience in India on the distinction based on pledge-mortgage, particularly with reference to shares and stock, has not been different.

1.2.14 The questionnaire of the Banking Commission's Study Group which reviewed legislation affecting banking has referred to a number of situations and drawn attention to decisions of courts where different conclusions have been arrived at on almost identical set of circumstances from bankers' practical point of view.[2]

IMPACT OF PLEDGE-MORTGAGE DISTINCTION IN COMPANY LAW

1.2.15 Registration with the Registrar of Companies by a bank of its *non-possessory* security interest over the stock in trade or any specific item of personal property of the company-borrower constitutes constructive notice of the interest of the bank to those dealing with the security. But as regards security interest with possession, the mere possession itself is regarded as notice. Hence, the scope of the doctrine of constructive notice does not extend to a pledge arrangement which is treated as conferring possessory security interest.

PLEDGE WITH PLEDGOR IN CONTROL

1.2.16 This presumption as to notice of the interest of the person in possession of the goods when applied to a case of constructive possession, especially where the control over the goods is with the debtor and the bank is held to be in legal possession, creates a situation whereby those dealing with the security in the hands of the owner-debtor—and such persons may be banks or other financing institutions themselves—are exposed to unnecessary risks. Again, since

[1]Grant Gilmore, "Security Interests in Personal Property", (1965), Vol. I, Little, Brown and Company, p. 7.

[2]Please see question Nos. 16.18.1 and 16.18.2 and the decisions in A.I.R. 1956 Patna 32; A.I.R. 1960 Andhra Pradesh 273; and A.I.R. 1969 Delhi 313.

pledge is not a registrable security interest, such a transaction cannot be registered, and even if inadvertently registered, does not attract the notice provision. Hence, where the secured goods are left under the control of the debtor, the Common Law doctrine of pledge on the basis of constructive possession is not made applicable in the statutes of Common Law countries where the law relating to security interests in personal property has been codified.

1.2.17 The facts of the case in Nadar Bank Ltd. *v.* Canara Bank Ltd.[1] will show how banks may come to grief if secret pledge arrangements, under which custody or control over the goods is left with the pledgor, are upheld.

HYPOTHECATION V. MORTGAGE

1.2.18 The legal position with reference to mortgage of moveables is obscure. However, mortgage of moveables is not ordinarily resorted to. Again, the cost of obtaining a mortgage over moveables is high since under the Stamp Act no distinctions are drawn in the rates of duty leviable between mortgage of moveables and mortgage of immoveables. This high cost is now avoided by banks by obtaining what they call hypothecation agreement which in law is said to confer only an equitable charge. When a non-possessory security interest is obtained with reference to chattels or goods, the further question whether the security interest is in the nature of mortgage or hypothecation is a purely technical one, and this should not affect the rights of parties.

TRANSFER OF INTEREST IN PROPERTY AND TRANSFER OF SPECIAL PROPERTY

1.2.19 Unlike in mortgage, in "pledge" no transfer of an interest in the security is considered as involved. On the other hand, pledge is said to involve creation of a special property in the goods pledged in favour of the pledgee. The rights of a pledgee and those of a mortgagee are not same. Hence, the distinction assumes practical significance. Working out this distinction in a case where creation of security interest is contemplated over shares and stock presents anomalies.

1.2.20 It is necessary to clear the ambiguities inherent in a transaction where shares, stock or choses in action are offered as security. Decisions on the rights of parties should not be allowed to be clouded by the question as to whether or not on a construction of a document, in the interpretation of which views may differ, only a special property in the chattels has been given, or an interest in the property has been transferred, to the secured party.

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[1]A.I.R. 1961, Mad. 321.

B. FIXTURES

1.2.21 Goods in the nature of pump-sets or other machinery are usually acquired on credit and they are offered as security to banks and other financing institutions. They may at some stage be either embedded or attached to land or buildings in agricultural farms or factories. The financing of acquisition of such goods is termed as fixture financing. The necessity for our credit-security law to adequately facilitate this type of financing to further economic development is obvious.

NATURE OF FIXTURE—FINANCING PROBLEMS

1.2.22 The reconciliation of the claims of the institution which has lent against the machinery before it is so attached or embedded, with those of one having an interest in such machinery as part of the real property is now a difficult question to resolve. Again, whether in a chattel or goods like the machinery which became fixture we could create a security interest without reference to the land or building to which they are already attached is a difficult question now to answer. Any answer is liable to be upset by the subjective assessment of courts as to the nature of attachment, intention of parties, etc.

CLAIMS OF COMMERCIAL BANKS AND TERM LENDING INSTITUTIONS

1.2.23 A commercial bank may finance the acquisition of machinery or a pump-set which may later on be attached or embedded to a factory or a farm against which a term lending institution may already have a charge or may obtain one subsequent to such annexation of the machinery.

1.2.24 As hypothecation is regarded as an *equitable* charge, the commercial bank which has financed the acquisition of the machinery may totally lose its security on the annexation of the machinery to the farm or the factory, if by such annexation the machinery is to be regarded as part of the immovable property to which it is attached or embedded. If, on the other hand, a valid *legal* charge is assumed in favour of the commercial bank prior to such annexation, merely by annexation of the security to the land or building—the commercial bank not being a party to such annexation—the charge over the machinery cannot be regarded as *ipso jure* extinguished. However, vis-a-vis the party claiming a security interest in the immovable property, its attempt to have recourse against the annexed machinery as accretion to the immovable property already charged to it may succeed, thus throwing into disarray financing arrangement with reference to acquisition of machinery.

ECONOMIC FUNCTION OF FIXTURE FINANCING NOW IGNORED

1.2.25 There are now no rules for the reconciliation, on reason or analysis, having regard to their economic function, of the claims of the commercial banks and term lending institutions while financing the acquisition of machinery, construction of factories, development of agricultural farms, etc., as regards security interests in fixtures. There is no good reason why a financing institution should lose its security interest in machinery or other similar fixtures merely by reason of what happens to such a security subsequently. The present legal position with reference to fixtures is so unsatisfactory that it poses serious and difficult problems in the credit-security arrangements of commercial banks and term lending institutions.

UNSATISFACTORY TEST OF ANNEXATION

1.2.26 The tests that are applied to decide whether the annexation is after all such as to make the machinery a part of the farm or the factory and thus an immovable property are so vague and equivocal that under identical set of circumstances courts have come to different conclusions. The questionnaire of the Banking Commission's Study Group which reviewed legislation affecting banking has referred to two decisions of the Madras High Court, one holding a pump-set to be a part of the agricultural farm and the other holding to the contrary.[1] Both these judgments are reported in the same volume of a law journal. If confusion is to be avoided, the conclusion should not rest on immaterial and fine distinctions; otherwise, commercial certainty will be affected and unnecessary risks will have to be undertaken by credit institutions, which will unduly inflate the cost of credit.

CROWTHER COMMITTEE'S VIEWS

1.2.27 Similar position exists in the U.K. and this has led to the following comment by the Crowther Committee[2] set up by the U.K. Government to go into consumer credit:

> "Special provisions should be made for security interests in goods which become fixtures. Present law on this subject is in an unsatisfactory state and can in a number of cases lead to unjustifiable loss by the chattel owner and unjustifiable enrichment by the owner of the land to which the chattel becomes affixed. ..... the whole principle could usefully be replaced by a set of simple rules doing justice to all parties."[3]

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[1] 1968 (2) M.L.J. 493 and 1968(2) M.L.J. 596.

[2] Report of the Committee on Consumer Credit under the Chairmanship of Lord Crowther, Cmnd. 4596, HMSO, London.

[3] Report of the Crowther Committee on Consumer Credit (1971), Vol. I, para. 5.7.78.

ANNEXATION TEST IS BEING DISCARDED

1.2.28 Similar problems have been faced in certain other Common Law countries, particularly in the U.S.A., and the rules with reference to fixtures have been specifically set out as part of a statutory scheme regulating the creation of security interests in personal property. These rules do not suggest a decision based on either the form of the security agreement or the nature of the annexation of the fixture. It is necessary that with reference to fixtures, we have to evolve similar rules so that the financing of machinery and other valuable goods which may become fixtures is not subject to undue risks.

1.2.29 It is necessary that reconciliation of the rights of the commercial bank vis-a-vis those of the term lending institution has to be with reference to the economic function of the credit given by them. This question should not be allowed to be clouded by technical and legal doctrines evolved at a time when fixture financing had not developed. As the Crowther Committee has recommended in the U.K. with reference to fixtures, there should also be provision in our country for registration so that the charge on a fixture can be a matter for constructive notice to persons dealing with the asset. It is also necessary to have equitable rules while enforcing charges against fixtures in order that the claims of those having interests in the immovable property are duly protected.

ACCESSIONS—PRESENT LAW UNCERTAIN

1.2.30 The Crowther Committee has recognised that English law is in a state of uncertainty as to the effect of accession on title to the accessory. That Committee has recommended that if "the law relating to security interests in goods which become fixtures is to be rationalised, opportunity might also be taken to deal with the question of accession to goods".[1]

1.2.31 The American position follows Roman and Scottish law and provides that there is no accession if the accessory can be detached from the principal goods without causing material damage to them. This avoids unjustifiable enrichment of the owner of the principal goods and the Crowther Committee has considered this a reasonable rule to adopt. Such rule may also be necessary for our country.

1.2.32 It is true that in our counrty, parts of a machinery are not charged to any lending institution independent of the machinery, e.g., the engine of a car. But it would be conducive to our economic development if our law could facilitate situations where a valuable part

[1]Report of the Crowther Committee on Consumer Credit, (1971), Vol. I, para. 5.7.80.

of a machinery is required and this could be obtained on credit from 'A' against a security interest comprising the part so acquired when the machinery itself is subject to a security interest in favour of 'B'.

1.2.33 'B' may not be willing to extend credit for acquiring the part vitally needed for the machinery unless the dues owing to it are wholly or partially discharged. This may result in economic waste of productive capacity capable of leading to unemployment. But credit-security law could help to reduce such situations if the pre-existing security interest in the entire machinery could take effect, as against the part supplied by "A", subject only to the security interest in that part of the machinery.

C. HYPOTHECATION AGREEMENTS

1.2.34 Banks obtain what they call a letter of hypothecation or a hypothecation agreement which is ordinarily stamped with duty as a mere agreement and which is regarded as conferring in favour of the hypothecatee an equitable charge which is enforceable against those with notice of the charge. The word "hypothecation" is used by banks in an omnibus fashion to cover several types of security agreements over different classes of property offered as security.

HYPOTHECATION—EQUIVOCAL EXPRESSION

1.2.35 Justice Ameer Ali had pointed out that the "use of the term 'hypothecation' *should be abandoned*. It is an equivocal and therefore dangerous word".[1] (emphasis added).

1.2.36 Again, under the name "hypothecation agreement" several forms of security arrangements get covered up. The hypothecation agreement may refer to hypothecation of a specified item of goods. With reference to inventory, it may take effect only as a floating charge. Again, there are hypothecations which have some overtones of pledge characteristics with totally different results as regards parties' rights.[2] Again, hypothecation may be to secure an instalment credit given for purchase-money as in the case of a hire-purchase agreement. Or it may be a hire-purchase agreement intended by the parties to operate as a charge in the nature of hypothecation.[3] The one thing clear about bankers' hypothecation is that the concept does not now help in an understanding of the real nature of the secured transaction.

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[1]Manmohan Mukherji *v.* Kesrichand Gulabchand, I.L.R. 1935 (LXII) Cal. 1046.

[2]Nadar Bank Ltd. *v.* Canara Bank Ltd., A.I.R. 1961 Mad. 321.

[3]Sundaram Finance Co. Ltd. *v.* The State of Kerala and another, A.I.R. 1966 S.C. 1178.

1.2.37. In Narasiah *v.* Venkataramiah[1], the Madras High Court has pointed out that hypothecation of moveables is not recognised by any statute. In H. V. Low & Co. Ltd. *v.* Pulinbiharilal Singha[2], the learned judge has observed that "in most modern systems of law, the hypothecation of moveables is either not permitted at all or is fenced in by a multitude of rules, which are absolutely necessary for prevention of fraud".

WHAT IS AN EQUITABLE CHARGE IN INDIA ?

1.2.38 While in the U.K. legal and equitable estates are both recognised, the judicial pronouncements there holding hypothecation as creating an equitable charge do not necessarily affect the fact that it is a secured transaction. In India equitable estates being unknown to our jurisprudence,[3] equitable charges are regarded only as warranting a personal action and binding, other than the immediate parties to the transaction, only those who have actual or constructive notice of the charge. Hence, it is that Shri J. C. Shah, former Chief Justice of India, has opined that *a creditor who has advanced moneys on hypothecation of goods has no property in the goods hypothecated and that it would be a misnomer to call him a secured creditor.*

HYPOTHECATION OF INVENTORY

1.2.39 Under a hypothecation agreement, particularly with reference to inventory or stock in trade, the debtor is allowed to dispose of or deal with the goods in the ordinary course of his business. The effect of such an agreement covering existing as well as future property is held as amounting only to the creation of a floating charge. So regarded, subsequent pledge or other disposal of the property to a person acting bona fide does not protect the bank which has lent against such hypothecation agreement[4].

HYPOTHECATION IN THE DISGUISE OF PLEDGE

1.2.40 While under an inventory charge in the nature of hypothecation, buyers and subsequent pledgees without notice are protected, a contrary result is arrived at where the arrangement is in substance the same but in form is regarded as in the nature of a pledge. The facts of the case in Nadar Bank Ltd. *v.* Canara Bank Ltd.[5] illustrate this aspect. Here, the Canara Bank which had granted a key loan lost

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[1]I.L.R. 1919 (XLII) Mad. 59.

[2]I.L.R. Vol. LIX, Cal. 1372 and Ghose on Law of Mortgage, 5th edn., p. 115.

[3]Tagore *v.* Tagore, (1872) 9 Beng. L.R. 37, I.A. Supl. Vol., 47; Mulla on the Transfer of Property Act, 1882. 5th edn., pp. 51 and 395.

[4]Narasiah *v.* Venkataramiah, I.L.R. 1919 (XLII) Mad. 59.

[5]A.I.R. 1961 Mad. 321.

its security interest, though it acted prudently. By reason of the debtor's suppression of the earlier arrangement with the Nadar Bank, the Canara Bank was prevented from having any knowledge of the claim of the Nadar Bank over the secured goods. Here, (while terming the arrangement as a pledge transaction) the Nadar Bank had permitted the debtor to deal with the goods without even a lock and key arrangement. This led to the subordination of the Canara Bank's security interest in the goods. This is a glaring instance where by reason of the form of the transaction being given undue prominence, a financing institution has to lose because of the laches of another financing institution.

1.2.41 Hypothecation now being in the nature of an equitable charge which is enforceable only against those having express or constructive notice thereof, the necessity has been felt for a scheme of registration of the security interests under hypothecation agreements. With reference to security interests in the assets of companies, registration is now provided for under the provisions of our Companies Act.

1.2.42 Since possession is a factor which would put others on notice of the claims of the person in possession, security arrangements in the nature of pledge are excluded from the scope of registrable transactions. Where the debtor is allowed possession of the goods, as in the "open credit" system considered in the Nadar Bank's case (which is in substance nothing more than a hypothecation agreement over inventory and which should normally be considered as conferring only a "floating charge"), there is now no protection to third parties dealing bona fide with the goods. This is due to the arrangement being considered as of a pledge type, though effective possession is with the debtor. Being termed a pledge, the security interest is not registrable. This results in even unregistered non-possessory security interest in the assets of companies being subordinated to bona fide registered security interests when the agreement is camouflaged as of a pledge type. In other words, when a hypothecation or a really non-possessory security interest takes the garb of a pledge, it brings about inequitable results. This highlights the necessity for the law relating to secured transactions to emphasise the substance and not merely the form of the transactions.

Classification based on nature of security

1.2.43 Under a hypothecation arrangement, all forms of assets other than immovable property could now be covered and the principles now applied (based on the case law development) make no distinction having regard to the nature of the goods covered by the transaction. The goods may be consumer perishables or consumer durables. They may

be fixtures which are intended to be attached or fastened to land or building, like machines in factories and pump-sets in agricultural farms. They may be floating security like inventory or stock in trade. They may be specific assets like the camera hypothecated in the case of Union of India and another *v.* C. T. Shentilanathan and another[1] decided by the Madras High Court.

1.2.44 It is obvious that the rules relating to perfection, priority, enforcement, etc., cannot always be uniform as regards all classes of assets covered by a security agreement. Hypothecation agreement over inventory cannot be treated entirely on par with hypothecation agreement over fixtures or over book debts. There is also no clarity in the legal position as regards the rights of banks and other financing institutions lending against the different classes of assets that may be covered by hypothecation agreements. This highlights the necessity for the law relating to secured transactions discriminating in appropriate cases. In other words, the failure to discriminate on substantial grounds to the extent necessary is also a defect of our present credit-security law.

SUPERVENING INSOLVENCY

1.2.45 In the event of insolvency, with reference to hypothecation, the judicial decisions have held that the preferential claim as a secured credit of a lending bank can only be with reference to so much of the funds as can be shown to represent the assets of the insolvent's business, which were in existence at the date of the letter of hypothecation[2]. When the hypothecation covers an inventory or stock in trade and the insolvency takes place after a lapse of time, in view of the revolving nature of the secured assets, the preferential claim may mean nothing, though section 534 of the Companies Act protects a floating charge created over the assets of a company one year *before* its winding up.

C. T. SHENTILANATHAN'S CASE

1.2.46 Thus, the legal effect of hypothecation agreements in favour of banks and other financing institutions, as deduced from judicial decisions, is far from clear. It is in this state of affairs that a further jolt has been given to the notions the bankers are having regarding the hypothecation agreements, by the decision of the Madras High Court in Union of India and another *v.* C. T. Shentilanathan and another.[3] Here, the Madras High Court had occasion to go in depth into the concepts underlying hypothecation agreements.

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[1]Judgment dated 29th October 1974 of Justice Ramaprasad Rao in Appeal No. 493 of 1969.

[2]In re. Ambrose Summers, 1896, 23 Cal. 592.

[3]Judgment of Justice Ramaprasad Rao in Appeal No. 493 of 1969.

"Hypothecation of goods is a concept which is not expressly provided for in the law of contracts but is accepted in the law merchant by long usage and practice. Hypothecation is not a pledge and there is no transfer of interest or property in the goods by the hypothecator to the hypothecatee. It only creates a notional and an equitable charge in favour of the hypothecatee and the right of the hypothecatee, as already stated, is only to sue on the debt and proceed in execution against the hypothecated goods, if they are available. As delivery of possession is not a *sine qua non* for the creation of a *notional* charge under a deed of hypothecation and as possession of the hypothecated goods is always with the hypothecator, a wide door is opened to the owner to deal with the goods without reference to the hypothecatee. If, however, the hypothecator contrary to the stipulation under the hypothecation bond, deals with the property, the breach on his part would certainly be noticed by the hypothecatee and he would be dealt with independently by him. It is in this context that the rights of a bona fide transferee for value of such goods are protected in law for the hypothecatee who fails to sequester the goods and reduce them into his custody, takes the risk of such clandestine dealings of the hypothecator. If the hypothecatee expressly or constructively notifies the equitable charge, matters would be different. Even so, when the hypothecator has constructive possession of the goods though not physical possession of the same. ..... In the absence of such a constructive notice or express notice to the public at large, *the right of the hypothecatee is that of a bare private money creditor with the ancillary right to proceed against the goods hypothecated after obtaining a decree in a Court of Law.* Thus, a hypothecation is a right in a creditor over a thing belonging to another and which consists in the power in him to cause the goods to be sold in order that his debt might be paid to him from the sale proceeds. *This right is distinguishable from a mortgage of chattels.* .....

It is therefore clear that there was no transfer of interest ..... as to sustain the contention ..... that the case under consideration involves a mortgage of moveable property ..... the best that can be claimed by the plaintiff in this action is an *equitable charge.*"

(emphasis added)

HYPOTHECATEE HAS NO LEGAL RIGHT TO TAKE POSSESSION

1.2.47 The Madras High Court's judgment[1] is in substantial accord with the views expressed by the Supreme Court in K. L. Johar's case[2]. Here, the Supreme Court had occasion to consider the status of a

[1]Judgment of Justice Ramaprasad Rao in Appeal No. 493 of 1969.
[2]A.I.R. 1965 S.C. 1082.

financier financing under a hire-purchase agreement (with an "option" clause). The point was whether the hire-purchase financier was only a financing intermediary extending credit against the goods or one giving the goods on instalment sale. While examining the various terms of such a hire-purchase agreement, the Supreme Court observed as under with reference to the clauses in the agreemnt providing for the hire-purchase financier to take possession of the vehicle and determine the agreement:

> "These clauses give power to the appellant to retake possession of the vehicle and determine the agreement. Now if the property in the vehicle had passed to the intending purchaser at the time of hire-purchase agreement, *it would not have been open* to the appellant to take possession of the vehicle ..... *Under the law all that the appellant would have been entitled to was to realise the loan he had given by filing a suit and then attaching and selling the vehicle.*" (emphasis added)

HYPOTHECATION AND HIRE-PURCHASE CREDIT

1.2.48 Thus, the effect of a bank advancing against hypothecation of a motor vehicle and that of a hire-purchase financier extending credit by entering into a hire-purchase agreement with an option clause, are now considered as different. This difference is basically related to the form of the security agreement adopted by the parties and ignores that in substance both the transactions are identical.

DISCRIMINATION IN EXTENDING CREDIT FOR PURCHASE MONEY

1.2.49 While credit for purchase money is given both by banks and hire-purchase financing institutions, the economic function they perform is the same. The law relating to instalment credit, or in other words, credit for purchase money, has not developed in our country in any rational way, but this is due to certain historical developments. We will be considering them in the next chapter.

EXERCISE OF RIGHT TO TAKE POSSESSION

1.2.50 At this stage we may note that though hypothecation agreements obtained by banks purport to give them the power to enter the premises of the defaulting borrowers and take possession of the security without recourse to judicial proceedings, the validity and scope of this right, when challenged, are doubtful. Apart from this, it is always a matter of practical knowledge that without the borrower's consent the lending institution is not now in a position to take possession of the security. After default it is only rarely that we can expect a borrower to voluntarily hand over possession of the security covered by the security agreement in favour of the bank.

ANALOGY OF HIRE-PURCHASE FINANCIER'S RIGHT OF SEIZURE

1.2.51 While banks have problems in having recourse against the security without instituting judicial proceedings, we may mention in contrast the right given to the hire-purchase financiers under the Hire-Purchase Act, 1972 (which is yet to come into force). Section 19(c) of the said Act enables a hire-purchase financier "to enter the premises of the hirer and seize the goods". In the event of default there is no such statutory protection extended to banks and other financing institutions as regards the assets secured to them. With reference to the rights of enforcement of the charge, we may have to ensure that the rights and privileges available to banks and other financing institutions are not in any event inferior to the rights and privileges given to other classes of financiers. While extending credit for purchase money, the status of banks should not be inferior to that of hire-purchase financiers who also extend credit for purchase money.

BANKERS' APPREHENSIONS

1.2.52 Subsequent to the decision of the Madras High Court in Shentilanathan's case,[1] bankers and their solicitors are having justifiable apprehensions regarding the secured character of the banks' advances against hypothecation of goods. The State Bank of India has viewed the judgment as appearing "to cut at the root of the security afforded by the hypothecation of goods".

MOVE FOR CODIFICATION

1.2.53 Messrs. King & Partridge, Solicitors, Madras, have written to several banks that while they do not fully agree with the conclusions of the Madras High Court, it would be better to codify the law relating to hypothecation of moveables. The Madras Centre of the Indian Banks' Association has also viewed that Government should be moved to codify the law relating to hypothecation.

1.2.54 The above analysis shows the urgent need for codifying the law relating to hypothecation. While codifying this branch of law we have to take care to see that we do not perpetuate the archaic and anachronistic concepts having no relevance to the current economic needs of our country.

D. TRUST RECEIPTS

1.2.55 In an import situation, a trust receipt is obtained when a bank releases documents or goods in which it has a security interest into the hands of its customer-importer. In an export situation, a

[1]Judgment of Justice Ramaprasad Rao in Appeal No. 493 of 1969.

bank may advance money to an exporter against a document which is called "trust receipt" whereby the customer agrees to purchase specific goods with finance and then hold the goods (and the proceeds thereof) in trust for and/or as agent for the bank. In the U.S.A. trust receipts are employed also for inventory financing. As Prof. Ziegel explains, "the trust receipt actually originated in England in the nineteen century ... The American lawyers now adapted it to meet the needs of domestic transactions".[1]

INTERNATIONAL BANKING PRACTICE

1.2.56 "Trust receipt" is an invention of mercantile necessity. "The trust receipt is not recognised as a form of security in either the civil law or the common law, but it is a creature of international banking practice that has become accepted throughout the world."[2]

SCOPE NOT FULLY AVAILED OF

1.2.57 Until the thirties of this century, trust receipts were relied on by banks in our country in extending credit. Subsequent developments have so much eroded the value of trust receipts that advances covered by them are now regarded only as unsecured credit.

1.2.58 It is unfortunate that no effective remedial measures to enhance the status of trust receipts have so far been undertaken in our country, though the necessity for the same has been pointed out for the past several decades by banks, associations of banks and different authorities. In the result, because of the lack of appropriate legal reforms in the law relating to trust receipts, while this type of credit is considered in other countries as safe and reliable, banks and other financing institutions in our country could not adequately extend this type of credit though there is vital need and ample scope for such form of credit.

BUSINESS EXPECTATIONS AND LEGAL UNDERSTANDING

1.2.59 Under a trust receipt, the customer "acknowledges that he holds the bill of lading and the goods in trust for and on behalf of the banker; that he will deliver them to the banker on demand; that he will not encumber the goods and will not dispose of them except

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[1] "Legal impediments to the financing of dealers' stock and accounts receivable", Jacob S. Ziegel, in "Instalment Credit", edited by A. L. Diamond, Stevens & Sons, (1970), p. 129.

[2] "Credit and Security—The Legal Problems of Development Financing", David E. Allan, Mary E. Hiscock, Derek Roebuck, University of Queensland Press, p. 80.

with the consent of the bank and on its behalf; and that he will keep any proceeds of sale separate and hold them to the bank's account."[1] In all countries where the trust receipt facilities have been extended by banks, conflicts have arisen between business expectations in respect of the trust receipt device and the legal understanding as regards the true character of the trust receipt document.

1.2.60 As pointed out in the report on the research project sponsored by the Asian Development Bank and the Law Association for Asia and the Western Pacific, while the expectations of the commercial community clearly are that the trust receipt achieves its stated objectives, to the lawyer several questions occur and not all of them have been clearly answered by courts, particularly with reference to the following aspects:

> "Can the bank's security created by assignment or pledge of the bill of lading subsist after the bill has been restored to the pledger or assignor, albeit for limited purposes? In so far as the trust receipt destroys the 'perfection' of the security by restoring the documents and the goods to the importer, can it be impugned as fradulent by third parties? Can the bank assert its right to the goods against the importer's execution creditors and trustee in bankruptcy? Can the bank assert its security against a *bona fide* purchaser from the importer without notice of its claim, or against any *bona fide* purchaser in the ordinary course of business? Can the banker claim proceeds in the hands of the importer, and how far can he follow them into a fixed fund?"[1]

NEED FOR LEGISLATION

1.2.61 In order to answer such question in a satisfactory way having regard to the commercial and banking needs of the country, a number of countries have enacted legislation to give a sounder legal basis to trust receipts and in the interest of certainty in the financing of international trade. The U.S.A., Canada, Sri Lanka and Taiwan are some of the countries where we find legislation has intervened to facilitate the spread of trust receipt facilities. For the U.K., the Crowther Committee has recommended legislation which would *inter alia* cover also trust receipts.

TRUST RECEIPTS ALSO HELP INVENTORY FINANCING

1.2.62 In the U.S.A., as we have pointend out earlier, trust receipts are employed not only in the context of international trade but also

[1] "Credit and Security—The Legal Problems of Development Financing", David E. Allan, Mary E. Hiscock, Derek Roebuck, University of Queensland Press, p. 81.

to facilitate inventory financing. In the words of Prof. Ziegal, inventory "financing was however too important to the American economy to be allowed to die and the National Conference of Commissioners on Uniform State Laws undertook a rescue operation in the form of Uniform Trust Receipts Act. This Act was first promulgated in 1933 and was subsequently adopted by a majority of the states. The Act has been superseded by Article 9 of the Uniform Commercial Code...".[1]

DEVELOPMENTS IN OUR COUNTRY

1.2.63 Now we will consider the several attempts made during the past several decades in our country to improve the status of trust receipts.

INVESTIGATION SUGGESTED BY THE INDIAN CENTRAL BANKING ENQUIRY COMMITTEE

1.2.64 Before the Central Banking Enquiry Committee gave the report in 1931, a decision of the Madras High Court clearly held that the debtor on a trust receipt could not be held liable on the basis that he has committed a breach of trust. To quote the words of M. L. Tannan, the learned author on Banking Law and Practice in India, this decision "has almost stunned the banking community in India".[2]

1.2.65 Under such circumstances, dealing with trust receipts the Indian Central Banking Enquiry Committee recommended that "the legal position as regards this matter may be investigated by the legal advisers of Government and such action taken as may be considered necessary".[3]

NO FOLLOW-UP ACTION

1.2.66 The follow-up action seems to have been left to the Controller of Currency who, it is reported, advised the Government in 1936 after consulting the Reserve Bank that this matter might be dropped as "there was no strong demand for action from banks who were primarily concerned".

JUDICIAL DECISIONS RE. TRUST RECEIPTS

1.2.67 Then came the three judgments of the Calcutta High Court directly on the question of trust receipts. They are the decisions in

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[1]"Legal impediments to the financing of dealers' stock and accounts receivable", Jacob S. Ziegel, in "Instalment Credit" edited by A. L. Diamond, Stevens & Sons, (1970), p. 130.

[2]M. L. Tannan, "Banking Law and Practice in India", 11th edn. (1968), p. 381.

[3]Indian Central Banking Enquiry Committee Report, (1931), para. 565.

re. Nripendra Kumar Bose,[1] in re. Summermull Singana[2] and in Chartered Bank of India, Australia & China *v.* Imperial Bank of India.

1.2.68 Justice Ameer Ali observed in re. Summermull Singana[2] that which appears on the document to be a trusts may fall within the reputed ownership, either because reputed ownership does apply in cases where a trust is of a secret or fictitious nature or because the court refuses to recognise such transactions as trusts at any rate as against outsiders. He summed up the position by saying that the "commonsense of the matter is this: that no special words or legal formula can preserve a control where actual control has been abondoned or maintain a connexion with the goods when the connection has been in fact severed ... if the exigencies of trade required that the goods must be handed over for sale, the seller takes the risk, he cannot put that risk upon the public which deals with his buyer ostensibly in possession of those goods as owner".

1.2.69 In the decision in the Chartered Bank of India, Australia & China *v.* Imperial Bank of India,[3] the Chartered Bank released the documents it was holding to the importer on his responsibility, on the importer signing the usual trust receipt in favour of the Chartered Bank. The importer pledged the documents subsequently to the Imperial Bank and then became an insolvent. Imperial Bank was held as *bona fide* pledgee for value without notice. The Chartered Bank lost its hold on the goods and the trust receipt was held subject to the reputed ownership clause. Though Tannan differs from this judgment, the fact remains that this and the other two decisions of the Calcutta High Court have further affected the value and utility of trust receipts.

1.2.70 The decision of the Privy Council in Mercantile Bank of India *v.* Central Bank of India[4] lends some support to the view that on a constructive pledge basis the release of goods against trust receipts may be sought to be legally supported. But this covers only import situations and not export credit arrangements like provision for packing credit, which are, or could be, financed against trust receipts. This does not also facilitate extension of the scope of trust receipt facility like its employment to cover inventory financing as in the U.S.A. Moreover, on an assessment of the law and practice governing trust receipts, as the learned author Tannan says, the "legal position as to trust receipts, however will continue to be regulated by the Calcutta

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[1]I.L.R. 56 Cal. 1074; A.I.R. 1930 Cal. 171.

[2]I.L.R. 59 Cal. 818; A.I.R. 1932 Cal. 680.

[3]I.L.R. 60 Cal. 1262; A.I.R. 1933 Cal. 366.

[4](1937) 65 Indian Appeal, 75.

decisons until reversed by the decision of any Superior Court and consequently from the banker's point of view trust receipts may be considered valueless".[1]

DEVELOPMENTS IN OTHER COMMON LAW COUNTRIES

1.2.71 At this stage we may note that the difficulties experienced with reference to trust receipt advances are not peculiar to our country alone. While in the U.S.A. recognition of such difficulties had led to positive legislative action resulting in trust receipt advances becoming available to a wider section of the customers of banks, particularly the smaller sections, in other countries, particularly in the U.K., some justification has been found for the survival of the trust receipt type of advances, on a constructive pledge basis.[2] Earlier we have seen how unsatisfactory is the doctrine of consructive pledge when the debtor holds the goods for the pledgee.

1.2.72 However, the development in the U.S.A. leading to the adoption of the Uniform Trust Receipts Act had its impact in India. This resulted in the moves initiated by the Exchange Banks' Association and the Indian Banks' Association to have similar legislation in our country. Now, we shall refer to such developments.

FIRST NATIONAL CITY BANK'S MEMORANDUM TO RESERVE BANK.

1.2.73 A notable development in this direction was the memorandum dated 26th December 1952 submitted by the First National City Bank to the Governor of the Reserve Bank of India. A copy of this memorandum is given as Annexure 1. The occasion for this was the discussion the then Governor of the Reserve Bank, Sir Benegal Rama Rau, had in New York with the representatives of the First National City Bank. By this memorandum the Reserve Bank was requested to move the Government of India to undertake suitable legislation to restore to trust receipts in some measure the efficacy and the utility which they commanded when this type of facility came into vogue.

1.2.74 The following extract from the memorandum merits reproduction:

> "In the United States of America also Trust Receipts appear to have undergone similar vicissitudes as in India but their legislation supervened as soon as the need for it was felt. The trust receipt operated in the United States originally as a common law device, but it was said that after some fifty years of this development the trust receipt was so swaddled in juristic chaos as to

[1]M. L. Tannan, "Banking Law and Practice in India", 11th edn., (1968), p. 382.

[2]Please see the decision of the House of Lords in North Western Bank *v.* Poynter, 1895 A.C. 56.

make legislation imperative (Commissioner's prefatory note to the Uniform Trust Receipts Act, 9 Unif. Laws Anno. 666). Accordingly, the National Conference of Commissioners on Uniform State Laws, roughly 20* years ago, proposed legislation which would have the effect of clarifying the uncertainties then inherent in the use of the Trust Receipt. The Uniform Trust Receipts Act was first adopted by New York in 1934 (New York Personal Property Law Sections 50-58-1), and has subsequently been adopted without material deviation in 28 additional jurisdictions of the United States."

ADVANTAGES OF TRUST RECEIPT LEGISLATION

1.2.75 The First National City Bank's memorandum recommended legislation in India on the lines of the Uniform Trust Receipts Act of the U.S.A., and the advantage for such an action was thus explained:

"In general, the Act is intended to work to the interest of Trust Receipt financiers by freeing their transactions of unnecessary and perplexing formalities, by clearly defining their rights, by simplifying their problems of proof in the event that the trustee becomes insolvent and by clarifying and making efficient the procedures which they must follow in order to foreclose on property or proceeds. It is intended to work to the interest of trust receipt borrowers by limiting their obligations to the writing, by cheapening their financing, by increasing the realisation of security on a foreclosure and by increasing the marketability of their assets by protecting purchasers."

VIEWS OF EXCHANGE BANK'S ASSOCIATION

1.2.76 The Bombay Exchange Banks' Assocation's memorandum to the Reserve Bank has adduced *inter alia* the following reasons for promoting in India legislation to cover trust receipt transactions:

"Although it is true that generally laws in India are modelled on the laws in England, there are instances in which India has taken the initiative and lead in legal reform and departed from the English law, in the light of India's own particular requirements, especially when codifying the principles of English Common Law and Equity in certain branches and departments of law.

Moreover conditions in India are not quite the same as in England where commercial conventions and standards have grown up in course of long years of dealings in foreign trade."

(emphasis added)

*i.e., 20 years prior to 1952.

ADVANTAGE TO SMALLER DEALERS

1.2.77 The advantage to smaller dealers and the impact of Trust Receipt legislation to stimulate commercial development of the country were thus stressed by the Bombay Exchange Banks' Association:

> "To the extent that a Trust Receipt can be made to provide effective security in merchandise or its proceeds, it would operate as a facility for merchants whose unsupported credit might be insufficient. Hence in the case of a country at the present stage of India's development, it would be desirable to adopt legislation which, by bringing certainty and effectiveness, stimulates the commercial development of the comparatively smaller dealers and traders in India, rather than letting them remain at a disadvantage as against established concerns due to the fact that their credit position has not yet been so well established.
>
> It would therefore be desirable for India to take the initiative in legal reform of this nature.
>
> Even though no demand for special legislation may have been made up to now, it cannot be disputed that ever since the Calcutta decisions referred to in the Memorandum submitted by the National City Bank of New York, Bombay, to the Reserve Bank, the uncertain and unsatisfactory position created by these decisions in regard to Trust Receipt transactions has been keenly felt by all bankers and even the mercantile community dealing with bankers in this country. Trust Receipts have lost their utility in Banking practice since these decisions.
>
> Since legislation can effectively remedy the legal confusion created by the above mentioned decisions, it is not necessary to wait until the Supreme Court has occasion to deal with the matter".

INDIAN BANKS ASSOCIATION'S VIEWS

1.2.78 We may also now refer to the points raised by the Indian Banks' Association, on the proposal to enact legislation to give effective legal status to trust receipts. The IBA had urged:

> "It is true that generally laws in India have been modelled on the lines of those prevailing in the United Kingdom with such changes as may be necessary to suit the requirements of local conditions. There have been cases, however, in which India has gone beyond the English law and enacted legislation of its own. We think that if legislation is enacted in India, so as to make a Trust Receipt provide effective security in merchandise

or its proceeds, it would benefit the operations of the smaller traders in India who, at present, are handicapped by the fact that their unsupported credit is regarded inadequate as against large established concerns. In our opinion, therefore, it is desirable for India to enact legislation to give effective legal status to Trust Receipts.

Since the decisions of some of the Indian High Courts, particularly of the Calcutta High Court, affecting Trust Receipts, banks and their clients have been feeling rather keenly the uncertainty created by the decisions, which have deprived Trust Receipts of much of their utility in banking practice. In this connection, your kind attention is invited to the recommendation of the Central Banking Enquiry Committee to the effect that the legal position as regards them may be investigated by the legal advisers of Government and that such action may be taken as may be considered nessary.

We are of opinion that the mercantile community would favour legislation giving effective legal status to Trust Receipts, because it would facilitate their obtaining financial facilities from banks...

It is true that *at present Trust Receipt facilities are given only to those parties whose creditworthiness is beyond doubt, but the object in suggesting that Trust Receipts should be given effective legal status is to make these facilities available more freely.*"[1]

(emphasis added)

EXPORT PROMOTION COMMITTEE'S RECOMMENDATIONS

1.2.79 Then the next stage came when the Export Promotion Committee pointed out the advantages of a trust receipt legislation for developing our exports. The Export Promotion Committee[2] stated that the failure of the exporter to ship the goods and to hand over the documents to his bank can be provided for only by enabling the banks to recover quickly the amounts advanced to the defaulting exporter. That Committee stated that this could be ensured if—

(a) trust receipts, i.e., the documents which exporters execute to obtain credit for exporting goods, could be registered with the Registrar of Assurances or some other authority; and

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[1]IBA's letter No. 248, dated 1st March 1954 addressed to the Reserve Bank of India.

[2]Paragraph 14, Chapter VI, of the Committee's report.

(b) upon violation of the provisions of the trust receipts, banks are able to rapidly bring criminal charges against the defaulter. The Committee appreciated that this would require legislation and, therefore, recommended that the requisite legislation should be enacted.

1.2.80 In the context of the need felt for a trust receipt legislation to develop our export, the Reserve Bank consulted the Indian Banks' Association and the Bombay Exchange Banks' Association, inviting their specific suggestions regarding the form of legislation. The Reserve Bank subsequently prepared a draft Bill on which it obtained the views of these Associations.

BANKS COULD NOT AGREE ON THE FORM OF LEGISLATION

1.2.81 There was also a subsequent discussion between the senior executives of banks and heads of other financial institutions and the Reserve Bank. While everybody felt the need for appropriate measures for enhancing the legal status of trust receipts there was no unanimity of views as to the lines on which legislation should proceed. Again, to provide for machinery for registration of trust receipts, obvious difficulties were noticed.

REVIEW BY BOMBAY EXCHANGE BANKS' ASSOCIATION

1.2.82 Subsequently, the Bombay Exchange Banks' Association had obtained legal opinion to the effect that the question of providing a draft form of trust receipt must be deferred until a decision was reached as to the shape of the actual legislation. The Chairman of this Association had then advised the Reserve Bank thus:

"At present a trust receipt does not create a valid trust. At the most it creates an equitable charge. Even if a bank claims under its rights as original pledgee the security is most undependable and unavailable against the official assignee and in case of a fraudulent sale or repledge against a purchaser or pledgee for value without notice. Also a bank will not always be in a position to prosecute the customer for breach of trust.

It would, therefore, be desirable to have comprehensive legislation based on the American model at least to cover trust receipt facilities granted by banks...

If a comprehensive legislation is introduced which would provide sufficient security to the lending banker by making trust receipts as good as any other form of mortgage security then it will not be necessary to rely on sanction of criminal proceedings to enforce banks' security.

...such a legislation will not only achieve the Export Promotion Committee's objective of facilitating export finance but will also help smoother financing of the increased trade and economic activity necessary for planned development."

VIEWS OF MESSRS. CRAWFORD BAYLEY & CO.

1.2.83 The legal opinion then obtained was in favour of legislation to improve the present state of the law and it was felt that banks might also welcome the extension of trust receipt device as a means of opening new methods of financing. After setting out what area should be covered by a trust receipt legislation and after citing the main features of the Uniform Trust Receipts Act of the U.S.A., Messrs. Crawford Bayley & Co., Bombay, a leading firm of solicitors and legal advisers to several banks, observed:

"We are of the view that if the trust receipt device is to be encouraged in India and if its uses as a financing device are to be extended *then legislation broadly along the lines of the American Uniform Trust Receipts Act should be introduced in this country. Any such new Indian legislation may also with advantage comprehend hypothecation and the like equitable securities.*

The extent to which the projected legislation should go is of course a matter for the legislation but in so far as our opinion is desired we think the scheme of the American Act could profitably be followed."

(emphasis added)

REGISTRATION RE. TRUST RECEIPT ADVANCES

1.2.84 Messrs. Crawford Bayley & Co. also considered the difficulties apprehended by bankers as regards registration of trust receipts. They felt that the existing machinery could be utilised with reference to companies and that as regards firms, the opportunity might be taken to amend the Partnership Act to require filing of various types of mortgage securities so as to bring the position in regard to partnerships in line with that of companies. As regards individuals and proprietary concerns, the solicitors advised the maintenance of a separate index by the Registrar of Assurances if and when compulsory filing of particulars of mortgage over moveables could be required under the Registration Act. Alternatively, with reference to sole proprietary concerns, they suggested the adoption of some provision for exhibiting notice of trust receipt financing in the business premises of the borrower.

RESERVE BANK'S EFFORTS TO PROMOTE TRUST RECEIPT LEGISLATION

1.2.85 Since there was hardly any measure of agreement as to the lines on which there should be legislation to enhance the status of trust receipts, the Reserve Bank of India then took up for consideration the possibility of promoting legislation on the lines of the American model, without providing for the registration of the trust receipts. At that time the question of evolving a satisfactory machinery for the registration of trust receipts was considered as impracticable and as it was then felt that it might not also be in the interest of banks, it was proposed that the legislation should give a form of trust receipt and also provide for penalty for breach of any terms thereof. In 1959 the Reserve Bank also advised the Government that it was making every effort to expedite the promotion of legislation.

BANKING COMPANIES (TRUST RECEIPT TRANSACTIONS) BILL PREPARED BY RESERVE BANK

1.2.86 Then the Reserve Bank decided to promote legislation on the lines of the American Uniform Trust Receipts Act without any provision for registration of trust receipts. The intention was to provide in the legislation a suitable form of trust receipt and penalty for breach of any terms thereof. Instead of registration, the proposal was to name an authority which could be considered for the purpose of *filing* of particulars of trust receipts. As opposed to "*registration*", it was considered that it would be more advantageous to provide for *filing*" of particulars of trust recipts with either (i) the Registrar of Assurances, (ii) the Registrar of Companies, or (iii) the Reserve Bank of India. The authority was to be required to maintain a separate register and an index and allow inspection of the documents. A Bill on these lines was prepared which the Reserve Bank referred to the Indian Banks' Association, the Bombay Exchange Banks' Association and the State Bank of India, for their comments. Views on the intended legislation were also sought from the Export Risks Insurance Corporation. The Reserve Bank Advised them that the Bill was broadly on the lines of the Uniform Trust Receipts Act of the U.S.A. with a restricted scope in as much as it would apply only to cases of trust receipts particulars of which are filed by banking companies under the legislation.

NO FILING REQUIREMENTS RE. PACKING CREDIT FOR EXPORT

1.2.87 At that time the Indian Banks' Association was not in favour of a provision which would require even filing particulars of trust receipts. This was also reasonable, at any rate with reference to the provision of credit against trust receipts for a short period. Even

the American Act, on the basis of which the draft Bill was prepared by the Reserve Bank, provided that during a period of 30 days from the date of execution of the trust receipt, the entrusters' right to the goods or documents was paramount to that of the creditors without any formal notice, filing or recording. Hence, a similar provision, it was felt, would obviate the need for filing in many cases, especially as regards packing credits to exporters.

STATE BANK'S VIEWS ON THE PROPOSED BILL

1.2.88 The State Bank of India also did not generally favour provision for registration of trust receipts. However, the State Bank felt that if a registration machinery was considered necessary, the registration should be with the registration authority established at the district level or with a central authority like the Registrar of Companies in each State. The balance of convenience, it was felt, would be to have a provision for the setting up of a central authority for registration of trust receipt transactions.

NO FURTHER POSITIVE ACTION

1.2.89 However, the proposals for legislation were not pursued beyond the stage of getting the comments of banks. Remedial action with reference to trust receipts had always been beset with difficulties. There was hardly any measure of agreement amongst banks regarding the lines on which legislation should proceed. As the Central Government and the Reserve Bank then looked to the commercial banks for a lead in the matter, the Central Government, it appears, finally decided, sometime in 1962, that the matter could be reviewed again after the recommendations of the Committee on Export Finance set up under the chairmanship of Shri K. P. Mathrani became available. However, that Committee did not refer in its report to the problem of trust receipts.

RESTRICTIVE VIEW IN 1965 REVIEW

1.2.90 There was a further review of the position in the Reserve Bank in 1965 when it was noted that there might not be any urgent need for trust receipt legislation in as much as banks' advances against trust receipts were not likely to be appreciable and the difficulties experienced by them in regard to such type of advances could be overcome by adhering to the practice of limiting the grant of such facilities to parties of repute and integrity. It was also then noted that trust receipt advances would come under the category of "unsecured advances" and it was then felt that it would be difficult to justify any legislation to facilitate such advances.

TRUST RECEIPT ADVANCES—BANKING REGULATION ACT CLASSIFICATION

1.2.91 In the above background, it is not surprising that item (ii) of the proviso to section 20(1) (b) of the Banking Companies Act, 1949 (as the provision then stood) referred to loans and advances made by a banking company against trust receipts as a form of unsecured loans and advances and in this view made special relaxation for giving such facilities to directors of banks when the law prohibited granting of unsecured advances to the directors. Subsequently, as advances to directors of banks were generally prohibited, whether on a secured or unsecured basis, the reference to trust receipts in section 20 of the Banking Regulation Act became unnecessary and was omitted for reasons not connected with the nature of advances against trust receipts.

RECOMMENDATIONS OF THE INFORMAL ADVISORY COMMITTEE

1.2.92 The Informal Advisory Committee appointed for the purpose by the Governor of the Reserve Bank to go into unsecured advances and unsecured guarantees also listed "advances against trust receipts" amongst the classes of *unsecured advances* which were to be excluded for applying the norms for unsecured advances laid down by that Committee and this recommendation was subsequently accepted by the Reserve Bank. *Such an exclusion was considered necessary so that "banks might not be inhibited from extending certain types of credit".*[1] (emphasise added). Notwithstanding this policy encouragement trust receipt advances by banks are now extended only to parties of high repute and standing, that is, they are not readily available to exporters and importers "whose unsupported credit might be insufficient".[2]

NECESSITY TO CODIFY LAW RELATING TO TRUST RECEIPTS

1.2.93 The trust receipt facility is necessary and may have to be provided by banks and other financing institutions to promote exports and facilitate imports. The release of documents against trust receipt in an import situation is traditional and needs no special mention. In relation to a packing credit advance, it will highly benefit *export promotion.* As in the U.S.A., it has great potential also for financing internal trade and commerce. Hence, if the law relating to trust receipts is codified, it will enable banks to play more effectively their role as catalysts of our country's economic development.

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[1]Circular of the Department of Banking Operations & Development, Reserve Bank of India, Bombay Section 5(g), p. 1, published by the Reserve Bank and intended for restricted circulation among the senior members of staff of banks.

[2]Memorandum of the Bombay Exchange Banks' Association enclosed with its Chairman's letter of 5th February 1954.

CODIFICATION SHOULD COVER ADVANCES AGAINST TRUST RECEIPTS AND ALSO OTHER SECURED TRANSACTIONS

1.2.94 It is true that there are some practical difficulties in providing a scheme of registration with reference to trust receipts. Hence, on grounds of public policy, the status of perfected security interest (that is, as if the security interest in favour of a bank is registered) may be conferred on trust receipt advances for a *short period* without the need for any registration, as has been provided for by legislation in the U.S.A., Canada, etc. By conferring this facility only to banks and other approved financing institutions and thereby insulating against fraudulent action and by providing for registration were the facility to continue on a *term longer* than any specified limited duration, we could effectively take care of trust receipt advances and also make them available to small merchants, and traders whose unsupported credit might be insufficient to enable them to avail themselves of this facility.

1.2.95 The object of legislation regarding trust receipts and other equitable charges is to make optimum use of the bank credit readily available for really productive and creditworthy purposes and to help small borrowers. In an era where banks and other financing institutions are shifting from a security-oriented approach to purpose-oriented lending, to fulfil certain broad socio-economic objectives to implement a radical economic programme which has as its main thrust benefiting small and weaker sections of the society, there is imperative need for legislation to cover trust receipts and other equitable charges.[1]

WIEWS ON THE QUESTIONNAIRE OF THE BANKING COMMISSION'S STUDY GROUP

1.2.96 Parts 16 and 17 of the questionnaire of the Banking Commission's Study Group which reviewed legislation affecting banking point to several glaring anomalies, in the legal infrastructure, which are now attributable to transactions secured against personal property. Banks and other financing institutions, chambers of commerce and other eminent persons have over-whelmingly indicated the necessity for a statutory scheme in our country to regulate the rights of parties as regards transactions secured by personal property.

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[1]Please see paragraph 1.2.83 supra, where reference has been made to a similar suggestion made by Messrs. Crawford Bayley & Co., solicitors, while advising the Bombay Exchange Banks' Association. This suggestion really anticipated the subsequent legislative developments in advanced countries. Had we acted on this suggestion, we would have gone ahead of many advanced countries in reforming our personal property security law.

CONCLUSION

1.2.97 In view of the chaotic state of the law relating to personal property in our country, it is necessary to codify this branch of the law. This would also implement the recommendations of the Banking Commission and of its Study Group which reviewed legislation affecting banking. It is in these circumstances that a new codifying and reforming statute has become necessary to regulate transactions secured against personal property. The foregoing analysis of the present position in our country with reference to security interests obtained by banks and other financing institutions and others dealing in transactions secured by personal property under the different forms of security devices now in vogue, like mortgage and pledge of moveables, hypothecation obtained by banks, hypothecation or mortgage over fixtures, trust receipt advances, etc., clearly points to the necessity for a fundamental re-orientation with reference to Common Law concepts now governing transactions secured by personal property. Such difficulties have been noticed by all other Common Law countries.

1.2.98 In other countries, recognition of such difficulties has led to the codification, clarification and reformulation of the principles with reference to transactions secured by personal property. We have to consider also the developments in other countries while codifying our personal property security law having regard to the special socio-economic requirements of our country.

CHAPTER 3

INSTALMENT CREDIT FOR PURCHASE MONEY

By "instalment credit for purchase money" we refer to credit which is given for the acquisition of machinery, motor vehicles and other goods under an arrangement whereby the goods so acquired constitute the prime security for the credit. Such credit is generally repayable in instalments. Credit for purchase money merits special recognition in our credit-security law owing to its significant role in the economic development of our country.

PURPOSE OF, AND PERSONS GIVING, INSTALMENT CREDIT

1.3.2 While dealing with instalment credit we have to refer both to the purpose of credit and to the providers of this form of credit. In purpose, instalment credit enables both business enterprises and individual consumers to acquire capital goods and consumer durables on credit which they can liquidate over a period of time by monthly or other convenient periodical instalments. Considerations relevant to the granting of *consumer credit* for enabling consumers to acquire consumer durables on instalment basis are not necessarily valid while considering the grant of instalment credit for genuine *business* requirements. By consumer credit we mean credit given for acquiring consumer durables like refrigerator, air-conditioner, etc. for personal, family or household use.

1.3.3 Instalment credit is now provided in our country mainly by commercial banks, State Financial Corporations, industrial development corporations of States, some co-operative banks and hire-purchase financing institutions. The Industrial Development Bank of India also refinances instalment credit provided by banks and State Financial Corporations. The economic function of instalment credit for purchase money would be the same, whether banks provide or the hire-purchase financing institutions provide this form of credit. In other words, no invidious distinctions between banks and hire-purchase financing institutions are warranted when both of them provide instalment credit.

1.3.4 The archaic nature of our credit-security law becomes obvious wher we find that while the law ignores the valid distinction based on the purpose of the instalment credit for purchase money, because

of its undue reliance on the form of the credit it has allowed an artificial and invidious distinction which operates to the prejudice of comercial and co-operative banks and development financing institutions like the State Financial Corporations vis-a-vis hire-purchase financing institutions.

INSTALMENT CREDIT BY BANKS

1.3.5 Instalment credit for purchase money is given by banks in the form of "hypothecation" against personal property (movable assets like machinery, pump-sets, motor vehicles, etc.). We have earlier indicated how on unsatisfactory foundations the law relating to hypothecation rests. Instalment credit for purchase money given by banks has to suffer such drawbacks as are now experienced with reference to banks' other forms of credit given against hypothecation.

1.3.6 The other popular form of granting instalment credit, namely, by means of "hire-purchase agreements", the form adopted by other financing institutions, is not now available to banks in the view that by entering into such an arrangement, a bank may be considered as engaging itself in a trading activity which it is precluded from doing by section 8 of the Banking Regulation Act, 1949. Similarly in the view that a "hire-purchase agreement" involves instalment sale of goods, State Financial Corporations and development financing institutions are also not permitted to undertake this business. This view is based on the form of "hire-purchase agreement" and ignores the substance of the arrangement which is essentially to give credit on a secured basis. However, with reference to a hire-purchase agreement of the nature considered by the Supreme Court in Sundaram Finance case[1] (that is, where the borrower termed as a "hirer" has no "option" to repudiate the sale), the legal position that the arrangement is only a secured transaction is now amply made clear.[2]

INSTALMENT CREDIT BY HIRE-PURCHASE FINANCING INSTITUTIONS

1.3.7 The hire-purchase financing institutions, which are now the major purveyors of instalment credit, grant instalment credit by entering into what they call "hire-purchase agreements". The major component of such credit given by hire-purchase financing institutions goes to the *road transport industry*. In so far as instalment credit is given for meeting the needs of the *industry* the necessity for consumer protection does not as such arise except the necessity to see that by reason

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[1]A.I.R. 1966 S.C. 1178.

[2]Please see Manasuba & Co. Private Ltd. by Official Liquidator v. Commissioner of Police, Madras and others, 1969 I Com. L. J., p. 5.

of the artificial and allegorical language used by the hire-purchase financing institutions in granting this form of credit — as we will see later — small business people are not affected. There are also certain other companies which give instalment credit by entering into a "hire-purchase agreement" for the purchase of consumer durables, which is a form of granting "*consumer credit*". With reference to instalment credit given for consumer needs, there is the necessity for consumer protection in addition to the necessity to guard against the evils like "snatch-back" which arise by reason of the recourse to the artificial form employed while giving credit. However, the evils of the system, which are attributable to the recourse to the artificial form, would disappear both for instalment credit to meet the needs of the industry and for instalment credit to meet the needs of the consumer once the transaction is looked at in its substance, that is, as a secured transaction.

INSTALMENT CREDIT FOR INDUSTRY

1.3.8 However, with reference to instalment credit, we are excluding from our present analysis the special factors that will require careful consideration from the standpoint of consumer protection. Here we are mainly dealing with the granting of instalment credit by banks and hire-purchase financing institutions for business requirements.

NEED FOR COMPREHENSIVE VIEW OF INSTALMENT CREDIT LAW

1.3.9 In so far as instalment credit is given by banks in the form of hypothecation, the several features of this form of instalment credit for business purposes or productive needs may be taken care of while codifying this branch of the law. While so doing, should we leave out instalment credit now given by hire-purchase financing institutions? Both on logic and with a view to ensure that credit for productive purpose is not hampered by unnecessary legal constraints, it becomes necessary to deal comprehensively with the law governing instalment credit for meeting the needs of industry, trade and commerce, whether such credit is given by banks or by hire-purchase financing institutions.

BACKGROUND RE. ADOPTION OF DIFFERENT FORMS OF SECURITY DEVICES

1.3.10 Instalment credit by finance houses took the form of "hire-purchase" initially in the U.K. in their anxiety to avoid the application of the provisions of the Bills of Sale Acts and the Moneylenders Acts. There is no scope for such apprehensions in India. Banks in our country are now giving instalment credit in the form of "hypothecation", in their apprehension that they should not come within the sweep of section 8 of the Banking Regulation Act 1949.

1.3.11 When we consider instalment credit in its plain meaning, that is, as a form of granting credit repayable in instalments (which is termed as "hire") and covering both the principal sum and the interest that may be payable thereon, banks should not be precluded from adopting the hire-purchase form. We do not have Bills of Sale Acts in our country. The hire-purchase financing institutions in our country are a kind of para-banking financial intermediaries which also accept deposits from the public for their lending activities. Such financial intermediaries are not to be classified as moneylenders and subjected to the States' moneylending legislation. As observed by the Study Group on Non-Banking Companies appointed by the Reserve Bank of India, the non-banking financial companies (NBFCs) "belong to the genre of commercial banks and their activities have to be regulated broadly on the same lines as those of commercial banks". It is for this reason that they are now treated as a class of non-banking financial institutions and specially dealt with both under Part III-B of the Reserve Bank of India Act, 1934, and under the directives of the Reserve Bank of India in this behalf. By reason of hire-purchase financing being seen in its true perspective, that is, as a form of secured transaction, the economic functioning of hire-purchase financing institutions should not be affected.[1]

1.3.12 In the view we are taking, the fact whether the form of instalment credit is termed as "hypothecation" or is termed as "hire-purchase", should not be relevant to decide the rights of parties. As we will presently see, the necessity for looking at a hire-purchase agreement in its true character, that is, as a form of secured transaction, has also been felt now in several countries of the Commonwealth including the U.K., Canada and Australia.

1.3.13 Adoption of such an approach is all the more necessary in India. The Study Group on Non-Banking Financial Intermediaries (1971) set up by the Banking Commission expected[2] that the Commission's Study Group to Review Legislation Affecting Banking (1971) would consider the different aspects of the law relating to secured transactions including hire-purchase finance. As the latter Study Group of the Commission could do only the spade work, this work of reviewing the law relating to secured transactions including hire-purchase finance has now devolved on the Banking Laws Committee.

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[1]Please see also the scheme of regulation recommended by the Banking Commission (1972) and paragraph 2.22 of the report of the Study Group on Non-Banking Companies set up by the Reserve Bank.

[2]Please see para. 4.2 of the Study Group's report.

HIRE-PURCHASE FORM—ITS HISTORICAL DEVELOPMENT

1.3.14 At this stage we may note how credit purveyors took recourse to "hire-purchase agreement" while giving credit against the security of personal property. In the U.K., initially the hire-purchase form "seems to have been largely confined to furniture, pianos and sewing machines among consumer goods; other goods sold on instalment terms seem to have been bought mostly on credit sale".[1] Granting of instalment credit for purchase money took the form of hire-purchase when the House of Lords decided in Helby *v.* Matthews[2] that a hirer under a hire-purchase agreement, who merely had an option to buy, was not one who had agreed to buy within the meaning of the Factors Act, 1889 and so could not by a wrongful sale pass title even to a purchaser in good faith.[3]

1.3.15 While all early hire-purchase business was financed by manufacturers or dealers who sold on hire-purchase terms, the emergence of specialised financing institutions for this purpose was a later development and in effect this has taken away the rationale of the decision in Helby *v.* Matthews.[4] After the first World War, large scale financing companies have developed when "the hire-purchase transaction on cars and some of the dearer durables acquired its characteristic triangular mechanism by which the seller, instead of disposing of the goods direct to his customer, sells the goods to a finance company which lets them to the consumer on hire-purchase. It is from this three-cornered pattern that many of the legal problems of hire-purchase arise".[5]

1.3.16 The era of manufacturer or dealer himself selling the goods to the consumer on hire-purchase basis has been replaced by a finance company intervening between the dealer and the purchaser. Under this arrangement, the financing company pays the dealer and after entering into a "hire-purchase agreement" gives the goods to the purchaser who is termed a "hirer". Another method followed by the hire-purchase financing companies which in the U.K. come under the classification of "finance houses", is to purchase "the contractual rights of agreements entered into by the dealer with the customer and so in effect buying

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[1]Report of the Crowther Committee on Consumer Credit (1971), para. 2.1.39.

[2](1895) A.C. 471.

[3]Report of the Crowther Committee on Consumer Credit (1971), para. 2.1.40.

[4](1895) A.C. 471.

[5]Report of the Crowther Committee on Consumer Credit (1971), para. 2.1.42.

receivables".[1] While the former method is called direct collection, the latter is termed "block discounting" which is usually accompanied by subsidiary arrangements by which "the dealer collects instalments as the finance company's agent and/or is made responsible for any loss arising from default"[2] of the purchaser.

1.3.17 As the Crowther Committee pointed out, "the layman would say that the finance house engaging in such a transaction is clearly lending money on the security of chattels".[3] But then, the finance houses would have been required to comply with the provisions of the Moneylenders Acts and the Bills of Sale Acts, "both of which are so restrictive as to make large scale business impossible".[4]

1.3.18 However, as we pointed out earlier, hire-purchase financing institutions in our country would not come under any such restrictive statutes; nevertheless, our hire-purchase financing institutions have followed the U.K. practice though there was no compelling necessity for them to do so. The circumstances under which the finance houses in the U.K. had to stick to hire-purchase form while providing instalment credit have no application in our country.

ABUSES OF THE HIRE-PURCHASE SYSTEM

1.3.19 While the bypassing of the Moneylenders Acts has by and large helped the consumers as it has facilitated "the great extension of credit to ordinary households, and the higher material standards of living based upon it.....the individual consumer was deprived of the protections the Acts were designed to afford, and it soon became apparent that other remedies against abuses were necessary".[4]

1.3.20 The abuses that were noticed with reference to hire-purchase form of giving credit were related to the exercise of the right of "snatch-back". Though the hire-purchase lender was termed owner-seller, the agreement also usually absolved him of any liability for the defects in the goods. Copy of the hire-purchase agreement was also not given to the purchasing customer.

1.3.21 Under such circumstances, to remedy such evils, the Hire-Purchase Act of 1938 was passed in the U.K. Under this Act certain obligations were imposed on the hire-purchase lenders, e.g., the necessity to give essential information relating to the terms of the credit,

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[1]Report of the Crowther Committee on Consumer Credit (1971), para. 2.1.44.

[2]*ibid.*

[3]*ibid.*, para. 2.1.45.

[4]*ibid.*

furnishing a copy of the agreement, and about the implied warranties as to quality of and title to the goods. The Act also limited the hirer's liability on the termination of the agreement and prohibited the owner from enforcing his right of repossession otherwise than by a court action where the financier terminated the agreement and the hirer had paid at least one-third of the hire-purchase price. The provisions of the 1938 Act of the U.K. were subsequently amplified in certain respects by the Hire-Purchase Act. 1954. The Hire-Purchase Act, 1972 of our country, which is yet to be brought into force, is based on the 1938 and 1954 Acts of the U.K.

1.3.22 There have been several radical changes in the U.K. with reference to instalment credit in hire-purchase form. In 1957, the Advertisements (Hire-Purchase) Act was enacted in the U.K. to prevent the unwary from being taken in by advertisements regarding the terms of the credit. In 1965 "the whole of the legislation regulating the rights of parties to a hire-purchase contract was consolidated in a new Hire-Purchase Act".[1] This legislation covered in addition to hire-purchase, also conditional sale and credit sale. The Advertisements (Hire-Purchase) Act of 1957 of the U.K. has consolidated the regulations relating to advertisements of hire-purchase business.

CROWTHER COMMITTEE REPORT

1.3.23 In 1968 the U.K. Government appointed a Committee under the chairmanship of Lord Crowther to review consumer credit. That Committee came to the conclusion "that it is neither possible nor desirable to make recommendations affecting consumer credit without re-examining the general law concerning credit transactions, and, in particular, security in personal property".[2] Since "the objective of any branch of commercial law should be to offer a fair and sensible solution to practical problems that are likely to arise in commercial transactions",[3] that Committee recommended a functional approach to regulation, identifying different forms of transactions possessing an essential unity of purpose and regulating them in the same way. Upon this basis, that Committee made recommendations for regulating hire-purchase transactions and other allied transactions as transactions secured against personal property. In the words of the Crowther Committee—

> "With the adoption of this fundamental concept, instalment sales as such will disappear as a legal notion and be recognised as what

[1]Report of the Crowther Committee on Consumer Credit (1971), para 2.1.56.

[2]*ibid.*, para. 5.1.1.

[3]*ibid.*, para. 5.2.1.

they are, namely, outright sales financed by loans repayable by instalments. This approach destroys the artificial and outmoded lender credit/vendor credit dichotomy and enables the legal treatment of monetary liabilities in a credit transaction to be coalesced into a single, unified structure based on the notion of a loan."[1]

NEW LEGAL FRAMEWORK

1.3.24 The new legal framework suggested by the Crowther Committee rests on the following two fundamental points:

(1) the recognition that the extension of credit in a sale or hire-purchase transaction is in reality a purchase-money loan and that the reservation of title under a hire-purchase or conditional sale agreement or finance lease is in reality a chattel mortgage securing a loan; and

(2) replacement of what are at present distinct sets of rules for different security devices by a legal structure applicable uniformly to all forms of security interests.

1.3.25 Based on this new functional approach, the Crowther Committee recommended for the U.K.—

(a) a Lending and Security Act containing provisions applicable to credit transactions generally whether in the sale form or in the loan form. This enactment will be of general application; and

(b) a Consumer Sale and Loan Act which will be a consumer protection statute.

1.3.26 Under the statutory scheme suggested by the Crowther Committee, the law is required to discriminate between consumer and commercial transactions. That Committee observed that "by separating consumer protection legislation from statutes of a general nature affecting credit transactions the policies which involve the former can be implemented without distorting the general legal structure".

PREVAILING TREND RE. INSTALMENT CREDIT LAW

Position in the U.S.A. and Canada

1.3.27 This broad classification of distinguishing credit as consumer credit and other business and commercial credit is also the prevailing pattern of legislation in the United States and Canada. In the U.S.A.

[1]Report of the Crowther Committee on Consumer Credit (1971), para. 5.2.4.

instalment credit for purchase money is now generally governed by Article 9 of the Uniform Commercial Code. The special features relating to consumer credit are now taken care of by the Uniform Consumer Credit Code (allied to it are the Small Business Loans Acts administered by the Small Business Administration). There are similar legislation in the provinces of Canada.

POSITION IN AUSTRALIA

1.3.28 In Australia, even as early as in 1969, a Committee chaired by Prof. Arthur Rogerson has concluded that "the continued use of hire-purchase as a means of granting instalment credit should not be possible".[1] The findings of that Committee have been substantially affirmed by the Molomby Committee[2] which has recommended for Australia the Chattel Security Act of general application and another legislation to deal with consumer credit. The Hon'ble V. F. Wilcox, Attorney-General of Victoria, has advised us that—

> "Model Bills — A Credit Bill and the Chattel Securities Bill — to give effect to the Report are in the course of preparation. While the Credit Bill deals mainly with consumer credit, the Chattel Securities Bill applies to all forms of personal property security. The recommendation on which it is based drew widely on Article 9 of the Uniform Commercial Code."

The Attorney-General of Australia, Hon'ble R. J. Ellicott, has advised us that draft Bills based on the Molomby Committee's Report would be available in the near future.

NECESSITY FOR FUNCTIONAL APPROACH

1.3.29 Thus, practically in all recent reviews of personal property security law in other countries of the Commonwealth, stress has been laid on the law being structured on a functional basis and on the necessity for dispensing with the dichotomy of vendor's credit and lender's credit and to look at hire-purchase credit as a form of instalment credit.

CONSUMER CREDIT ACT, 1974 OF THE U.K.

1.3.30 Now we may also add that recent legislation in developed countries has given effect to such functional approach. While the scheme recommended by the Crowther Committee has been implemented in the U.K., with some modifications, as regards consumer

[1]The Report on the Law relating to Consumer Credit and to Moneylending, 1969, Chapter 2.

[2]The Report on Fair Consumer Credit Laws submitted to the Hon'ble Attorney-General for the State of Victoria read with the supplementary report to the main report.

credit, the recommendations with reference to the statutory scheme to deal with secured transactions in general are under consideration. Before deciding on this, the U.K. Government intend to institute consultations with those most closely concerned.[1] But referring to the Consumer Credit Act, Prof. R. M. Goode, the U.K. authority on the subject, has advised us that this Act "at the consumer level represents an extremely useful fusion of treatment of the different forms of credit, with the creation of a new system of classification of credit agreements based on functional considerations and not on the old formal legal distinctions between sale credit and loan credit."

SECTION 24 OF THE SOUTH AUSTRALIAN ACT

1.3.31 While dealing with the instalment credit in the form of hire-purchase, we may refer to the relevant portions of section 24 of the Consumer Transactions Act, 1972, of South Australia which provides that—

"(1) the property in any goods subject to a contract that constitutes, or to contracts that together constitute, a hire-purchase agreement, shall pass to the consumer upon delivery of the goods to him;

* * *

(3) the rights of the supplier under such contract or contracts shall be secured by a mortgage in terms prescribed by regulation;

* * *

Earlier, the Rogerson Committee in Australia had observed that the continued use of hire-purchase as a means of granting instalment credit is impossible. Thus, in Australia, hire-purchase credit has come to be recognised essentially as a secured transaction.

REVIEW BY THE BANKING COMMISSION'S STUDY GROUP

1.3.32 The Banking Commission had set up a Study Group to review legislation affecting banking, and this Study Group had considered the law in our country with reference to instalment credit transactions. This Study Group pointed out that a fresh look at our hire-purchase legislation would have to be taken.

1.3.33 This Study Group pointed out that[2]—

(i) "the precedent of the Hire-Purchase Acts, 1938 and 1954 of the U.K. which was relied by the Law Commission for its

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[1]Reform of the Law on Consumer Credit (Cmnd. 5427), HMSO., p. 9.

[2]First Report of the Study Group Reviewing Legislation Affecting Banking—Banking Regulation, (1971), Manager of Publications, Delhi, (PFD 209), paras. 8.25 and 8.26.

recommendations to exclude credit sale (as also conditional sale) contracts from the scope of the legislation proposed by that Commission, has not been followed in the U.K."; and

(ii) "the trend now, as seen from the legislation and considered views in the U.K., U.S.A., Australia and other countries, is to unify the scheme of legislation relating to credit for the acquisition of goods, whether the relative transaction is couched as hire-purchase or credit sale or conditional sale."

BANKING COMMISSION'S RECOMMENDATIONS

1.3.34 Considering the matter further, the Banking Commission recommended that "on the law relating to instalment credits, the Hire-Purchase Bill, 1968, in our country, does not take note of the recent developments in the U.K., the U.S.A., and in other countries. This measure requires further consideration".[1]

FICTION OF "OWNERSHIP" IN HIRE-PURCHASE FINANCE

1.3.35 At this stage it is relevant to refer to the validity, in real terms, of the concept of "owner" and "hirer" employed in hire-purchase business and the point of distinction now made in our country as to when a hire-purchase transaction is really a secured transaction and when it is not and whether such distinction has any substance.

ALLEGORICAL LANGUAGE

1.3.36 Under the hire-purchase system, "the mutual rights and obligations of a lender and a borrower or to adopt the words used in hire-purchase agreement, the 'owner' and the 'hirer' are curiously veiled in mercantile allegorical language. Such inherence of allegory and peculiar words in the documentation of the system, has compulsorily led courts of law to pierce through such a commercial veil and find out the real scope and intendment of the bargain".[2] While the arrangement is one of instlment credit, legal archaism gives shape to the arrangement as if it is instalment sale.

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[1]Report of the Banking Commission (1972), Manager of Publications, Delhi, (PFD. 205), para. 21.53.

[2]Ramaprasada Rao, J., in Manasuba & Co. Private Ltd. by Official Liquidator *v.* Commissioner of Police and others, (1969) I Comp L.J., p. 21.

1.3.37 Two typical forms of hire-purchase agreements have come in for appraisal before our Supreme Court in K. L. Johar's case[1] and in Sundaram Finance case.[2]

JOHAR'S CASE VIEWS HIRE-PURCHASE AS INSTALMENT SALE

1.3.38 In K. L. Johar's case, the Supreme Court was concerned with the true nature of the payments made as hire in the hire-purchase agreement. Considering this question, the Court held that "*part of the amount is towards the hire and part towards the payment of price*".[3] But the Court was having difficulty to determine what portion of the hire would have to be attributed towards payment of the price. The Court felt that "there is no legislative guidance available as to how this should be done and perhaps it will be better if the legislature gives guidance in such matters".[3] In other words, the Supreme Court considered the arrangement as one of instalment sale and not of instalment credit.

SUNDARAM FINANCE CASE VIEWS HIRE-PURCHASE AS INSTALMENT CREDIT

1.3.39 In Sudaram Finance case, the Supreme Court had occasion to consider the true nature of the transaction. Looking at the transaction in its true character without regard to the veiled terminology adopted in the hire-purchase agreement, the Supreme Court held that the arrangement was really one of secured financing. Here the Supreme Court held that the intention of the hire-purchase financier "in obtaining the hire-purchase and the allied agreements was to secure the return of loans advanced to their customers, and no real sale of the vehicle was intended by the customer.....The transactions were merely financing transactions".[4] No doubt, in this case the Court distinguished its earlier decision in K. L. Johar's case. in the view that there was an option available to the hirer to repudiate the purchase under the terms of the agreement considered in Johar's case. But the presence or absence of an option clause in practical sense has not much significance and does not really affect the nature of the hire-purchase transaction.

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[1]Messrs. K. L. Johar & Co. *v.* The Deputy Commercial Tax Officer, Coimbatore III, A.I.R. 1965 S.C. 1082.

[2]A.I.R. 1966 S.C. 1178.

[3]A.I.R. 1965 S.C. 1082, at para. 22.

[4]A.I.R. 1966 S.C. 1178, para. 28.

RESERVE BANK'S VIEWS AFTER SUNDARAM FINANCE CASE

1.3.40 After the decision in Sundaram Finance case in 1966, the Reserve Bank of India viewed that where a bank was in substance a mere lending or financing agency and had not

(a) transferred, or made any application for the transfer of, the registration of the motor vehicle in its own name or in the name of any of its nominees, or

(b) obtained or made any attempt to obtain physical possession of the motor vehicle financed by it,

before the loan or advance becoming bad or doubtful of recovery, the provisions of section 8 of the Banking Regulation Act would not be relevant and should not be deemed to have been attracted. However, though this view purports to be based on the Supreme Court's decision in Sundaram Finance case, it does not take note of the fact that even in Sundaram Finance case the Supreme Court had confirmed also the Johar's case and upheld the view that hire-purchase was an instalment sale, at least with reference to a transaction where the hire-purchase agreement gave an "option" to the hirer to repudiate the sale.

1.3.41 Evidently in view of the above, while the Study Group on Road Transport Finance (1968) appointed by the Government of India had welcomed the Reserve Bank's liberal interpretation of section 8 of the Banking Regulation Act and wanted the attention of all commercial and co-operative banks to be drawn to such interpretation, the Study Group of the National Credit Council (1969) which considered the provision of credit facilities for road transport operators commented on this interpretation that "this liberalisation seems, however, to be intended, in terms of the Reserve Bank's circular dated the 25th November 1966, to be confined to cases where the financing commercial bank *refinances* a hire-purchase financier or finances an operator *and the hire-purchase sale of motor vehicles directly by a bank*, does not seem to have been envisaged. *Commercial or co-operative banks cannot, therefore, carry on hire-purchase financing directly as a part of their own business*".[1] (emphasis added). Thus, the bar of section 8 of the Banking Regulation Act, 1949, on the banks giving instalment credit on hire-purchase is again felt. At this stage, we may refer to the ratio of the decisions in Johar's case and in Sundaram Finance case as that would bring out clearly the area in which this theory of instalment sale as opposed to instalment credit operates in the field of hire-purchase financing.

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[1]Report of the Study Group of the National Credit Council, para. 24.

RATIO OF THE DECISIONS

1.3.42 The resulting ratio of the decisions of our Supreme Court in K. L. Johar's case and in Sundaram Finance case is clearly brought out in the decision in Official Liquidator, Manasuba & Co. (Private) Ltd. *v.* Commissioner of Police, Madras and others.[1] While a hire-purchase agreement expressly stating an option to the hirer was held in Manasuba's case as not coming within the grip and mischief of sections 125 and 132 of the Companies Act for non-registration under that Act when the hirer was a company-borrower, the type of agreement considered in Sundaram Finance case, that is, hire-purchase agreement where there was no express option clause, was held as hit by the provisions of the said sections and hence as not enforceable against the official liquidator of the hirer-company unless the security interest was registered under the Companies Act, 1956.[2]

"OPTION" CLAUSE CREATES THE VEIL

1.3.43 Thus, only in the type of hire-purchase agreement considered in Johar's case the concept of "owner" and "hirer" still remains for consideration notwithstanding that in all hire-purchaser agreements the terminology used is the same. Thus, partially, without the need for legislation, our courts have been able to decide about the transaction by looking at the substance of the hire-purchase agreement by piercing the allegoric veil in which the terms of the contract are expressed. Though the veil is pierced and is in tatters, it still remains, that is, with reference to the hire-purchase agreement where the hirer is said to have an option. This tottering and torn veil would naturally fall once the law recognises the fact that the option to the hirer is never contemplated to be exercised by the hirer-borrower at the time he entered into the hire-purchase agreement.

"OPTION" CLAUSE HAS NO PRACTICAL SIGNIFICANCE

1.3.44 Since the true nature of a hire-purchase agreement is said to rest on the option available to the "hirer" to repudiate the purchase, it is relevant to note that the parties really do not contemplate that the hirer would exercise his option not to buy. As Prof. Aubrey L. Diamond describes the position :

> "The whole *concept of the hire-purchase agreement is basically a fiction.* In law it is, as we have seen, a hiring coupled with an option to buy. But there is no true hiring in hire-purchase —

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[1]1969 I Comp. L. J., p. 5.

[2]In Manasuba's case while the former class of agreements was referred to as hire-purchase agreements, the latter was described as refinance hire-purchase agreements. But the distinction between them rested only on the presence or absence of an express clause providing an option to the hirer not to buy.

it is not really contemplated, when the transaction is entered into, that the 'hirer' should wish to return the goods."[1]

(emphasis added)

"OPTION" PRICE NOMINAL

1.3.45 It is also borne out by the fact that in most hire-purchase agreements with an option clause the price for exercising the option clause is nominal. In K. L. Johar's case, for the exercise of the option, there was only a nominal amount of Re. 1 to be paid.

ANOMALIES DUE TO THE "OPTION" CLAUSE

1.3.46 On the basis of there having been a sale, in K. L. Johar's case the court had to go into the purchase price for the motor vehicle. While the financiers contended that the sale price should be regarded as Re. 1 which the hirer had to pay when he exercised his option to purchase, the other view was to regard the entire amount paid by the hirer as the sale price. This led the Supreme Court to hold that the hire included not only what would be payable really as hire but also a part of it towards the price. In Johar's case legislative guidance was desired in solving this difficulty of apportioning the instalment amount towards hire amount and purchase consideration. Thus, we see in Johar's case the impossibility of taking the option clause in a hire-purchase agreement at its face value.

1.3.47 The view that the instalment though termed as "hire charges" covers a portion of the purchase consideration is necessary in order to avoid the ludicrous conclusion that a costly vehicle is worth only Re. 1 at the time the option is exercised. But this view brings in its wake further anomalies. This assumes that were the "hirer" to exercise his option not to buy in terms of the agreement, the "owner" would refund to the "hirer" that portion of the instalments so far paid which is apportionable towards the purchase consideration, as the "owner" cannot retain with himself any portion of the purchase price if the agreement to purchase does not fructify. The fact that this right is not given to the "hirer" under the agreement (whether under present law the "hirer" could claim refund or adjustment of the price portion of the instalments is probably not yet judicially decided)[2] clearly shows that repudiation by "hirer" is not contemplated by the parties.

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[1]A. L. Diamond, Instalment Credit, 1970, Stevens & Sons, page 39.

[2]The doubts on this question will cease after the Hire-Purchase Act, 1972 is brought into force. Section 19(a) of this Act entitles the 'owner' "to retain the hire which has already been paid and to recover the arrears of hire due". Since 'hire' is defined in this Act as "the sum payable periodically by the hirer under a hire-purchase agreement", it would include also purchase consideration component included in a hire-purchase contract.

1.3.48 On the contrary, the hire-purchase agreement provides for a minimum payment clause were the hirer to default or terminate the agreement. The stipulations under the minimum payment clause are such that they will deter the "hirer" from repudiating the agreement. This is made clear by Diplock, L. J., in Financings Ltd. *v.* Baldock[1] when he observed :

> "The business nature of the transaction is that of money-lending, and accordingly clauses are inserted by the finance company in the contract of hire in an endeavour to ensure that upon breach by the hirer of his obligation to pay an instalment of hire, the finance company shall be entitled, not only to terminate the contract of hire, but also to recover from the hirer sums which bear no relation to the damages appropriate to a breach of a genuine contract of hire."

COST OF INSTALMENT CREDIT AND THREE-TIER SYSTEM

1.3.49 The three major of institutions in the field of instalment credit in our country are : (i) private hire-purchase financing institutions, (ii) commercial banks and (iii) State Financial Corporations. Banks and State Financial Corporations also avail themselves of refinance from the Industrial Development Bank of India. The aim of such refinancing arrangement is to help the development of the industry which relies mainly on instalment credit. Hence, it is necessary to ensure that the benefit of such refinancing which is somewhat on concessional terms is felt to the maximum possible extent by the industry. Though the private hire-purchase financing institutions now cater to the bulk of the requirements as to instalment credit,[2] their resources for extending this credit come, apart from their equity capital, mainly from deposits obtained by them from the public and from commercial bank loans. Where a private hire-purchase financing institution avails itself of credit from a bank or a State Financial Corporation which gets refinance from the Industrial Development Bank of India under any available scheme, a three tier system develops in the field of instalment credit.

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[1](1963) 2 Queen's Bench 104, C. A.

[2]The Banking Commission's Study Group on Non-Banking Financial Intermediaries estimated the quantum of instalment credit that may be required by the end of 1973-74 for the transport industry, trucks and trailers, farm machinery and producers' goods at Rs. 260 crores. Of this, the State Bank Group and the nationalised banks were expected to advance a sum of Rs. 100 crores, the State Financial Corporations a sum of Rs. 5 crores and the private hire-purchase financing institutions a sum of Rs. 155 crores (paras. 4.4 to 4.6 of its report). This quantum assessment was made without weighing the price-increase factor.

1.3.50 While the private hire-purchase financing institutions have developed an expertise which ensures a place for them in the instalment credit system of our country[1], such institutions also suffer from organisational defects such as the large number of small sized units. The Study Group of the Banking Commission also pointed out that "high rates of interest charged or forcible repossession of vehicles for which hire-purchase finance had been extended usually characterise the operations of the smaller units".[2] Hence, the Banking Commission and its Study Group recommended that the commercial banks should enter in a big way in the provision of instalment credit and that at the same time the hire-purchase financing institutions should also be disciplined by requirements as to licence, etc.

1.3.51 The Banking Commission's Study Group on Non-Banking Financial Intermediaries said that "it may be left to the banks concerned to decide whether they should enter hire-purchase business by having a specialised department or by having subsidiaries or in any other way".[3] However, the Study Group also referred to the legal difficulties in the way of banks giving directly instalment credit in hire-purchase form. It observed that "the legal position is that there is a distinction between hire-purchase transaction and the financing of a hire-purchase transaction. If the banks want to carry on hire-purchase business, they will have to do it only by way of financing the hire-purchase transactions entered into between persons selling and buying goods on hire-purchase basis."[4] Thus, while banks are in a position to refinance instalment credit given in hire-purchase form, they are not in a position to give directly instalment credit under a hire-purchase agreement, for the acquisition of goods.

1.3.52 From the studies carried out by the Banking Commission and its above Study Group, it is clear that in all parts of our country we do not have competent private hire-purchase institutions which could provide instalment credit by availing themselves of funds if necessary through commercial banks. Hence, provision of instalment credit directly by banks may be necessary, or may become necessary, in several areas of our country, if not in all parts.

1.3.53 Provision of instalment credit directly by banks may also result in considerable reduction in the cost of credit by reason of the elimination of an intervening tier at least in places where there

[1]Report of the Banking Commission's Study Group on Non-Banking Financial Intermediaries, para. 4.7.

[2]*ibid.*, para. 4.9,

[3]*ibid.*, para. 4.21.

[4]*ibid.*

are now no properly functioning hire-purchase financing institutions. The Study Group of the Banking Commission listed the following difficulties reported to have been experienced by banks in providing instalment credit on hire-purchase terms :

"(1) In case of default by hire-purchase financier, it is difficult to realise bank's security if the goods involved are vehicles, trucks, etc.

(2) Valuation of second hand vehicles is difficult.

(3) Scope for availing of credit from more than one bank on the basis of duplicate documents from original borrowers cannot be eliminated.

(4) Banks do not have effective follow-up of repayments and also have no control over security or regulation of ultimate lending rate.

(5) Financiers advance indiscriminately even to unauthorised persons which is in contravention of the rules of the banks.

(6) Financiers do not maintain proper books of account and do not submit periodical statements to the banks; and

(7) Insurance companies generally delay the settlement of claims under various pretexts."[1]

Of the reasons cited, it may be noticed that the difficulties listed at Nos. 1, 3, 5 and 6 are essentially factors arising from the routing of bank funds for the provision of instalment credit through other financial intermediaries such as private hire-purchase financing institutions. These difficulties may, by and large be overcome more effectively when banks provide instalment credit directly. In addition, the cost of credit to the industry which avails itself of instalment credit would also be considerably reduced by reason of direct financing by banks instead of through other intermediaries, at least in areas where there are no properly functioning or efficient private hire-purchase financing institutions.

1.3.54 We may quote the evidence of Shri T. S. Santhanam. Chairman of the South India Hire-Purchase Associations, Madras, given before the Joint Committee on the Hire-Purchase Bill, 1968 :

"As persons interested in the transport industry, we feel that what is required first of all is that more and more people should enter this business. Every encouragement should be

[1]Report of the Banking Commission's Study Group on Non-Banking Financial intermediaties, para. 4.12.

given so that there is free competition, and more money flows in. The Scheduled Banks also should be persuaded, if not forced, to give assistance, so that the quantum of business will grow, there will be more competition and more money will be available not only for new vehicles, but also for second-hand vehicles."[1]

1.3.55 In order that banks are encouraged to provide instalment credit directly, wherever there is scope for the same, it is necessary to ensure that there are no legal impediments in the way. Viewing instalment credit given on hire-purchase terms, having regard to the substance of the arrangement that is, as a secured transaction, effectively removes the legal impediments in the way of banks providing instalment credit directly. Unless the legal impediments are eliminated, banks will be handicapped from developing the expertise necessary for providing instalment credit directly, since the "hypothecation" form they have recourse to does not adequately safeguard their interests.

PRIME LENDING AGENCIES FOR INSTALMENT CREDIT

1.3.56 While reviewing the provision of credit facilities for road transport operators, the Study Group of the National Credit Council (1969) had pointed out, after referring to the legal impediments in the way of banks extending credit on hire-purchase basis, that as the law stands it is only the hire-purchase finance companies which "will have to be the primary lending agencies and are in a favourable position to grant assistance to the small operators".[2] Apart from the operational expertise which these companies may have developed, the following factors have been referred to as contributing to the hire-purchase finance companies being the primary lending agencies providing instalment credit on hire-purchase basis :

"(i) The enjoyment by the lender, as the owner, of the right of repossession or of a secured creditor in liquidation, which is superior to that of a mere financier ;

(ii) The easy realisation of the loans advanced through monthly or other periodical repayment ; and

(iii) The loading in the "flat" rate of interest charged to the hirers, of the very substantial expenses on account of management, inspection, supervision and control".[3]

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[1]RAJYA SABHA—Joint Committee on the Hire-Purchase Bill, 1968 p. 60.

[2]See para. 25 of the Report of the Study Group of National Credit Council (1969).

Of the advantages listed, factors Nos. (ii) and (iii) could be generally common for all forms of instalment credit irrespective of the institution providing the credit. The factor No. (i) is no doubt now available only to hire-purchase financing institutions in respect of the hire-purchase agreements with an option to the hirer to repudiate the purchase. Since in such type of cases the theory of instalment sale prevails, the hire-purchase financing institutions enjoy an advantage which is denied to commercial banks and development banks which are also now providing instalment credit.

ARE HIRE-PURCHASE FINANCING INSTITUTIONS TRADING CONCERNS?

1.3.57 While dealing with the status of hire-purchase finance companies, the Study Group on Road Transport Financing 1968 chaired by Shri R. G. Saraiya has said that as financial intermediaries they should not extend their interests to either trade or industry.[1] This Study Group has also recommended that hire-purchase companies should not undertake any business other than financial business. If hire-purchase finance companies are regarded only as financing institutions, the anomaly in regarding them as sellers of goods under the hire-purchase agreements and thereby engaged in trading—whether there is an option clause or not in the hire-purchase agreements—is obvious. In fact this Study Group's recommendation aims to apply to hire-purchase financing institutions the principle underlying section 8 of the Banking Regulation Act, 1949. It underlines the necessity for both banks and hire-purchase financing institutions functioning broadly under same conditions of regulation.[2] Thus, the instalment sale concept in hire-purchase financing business gives an artificial colour to the transactions entered into by hire-purchase financing institutions.[3]

1.3.58 It is in view of the legal theory that a hire-purchase financing company providing instalment credit by carrying on hire-purchase business may be regarded as trading in the goods in which it also deals on a hire-purchase basis, that the Study Group on Non-Banking Companies (1975) has suggested an exception with reference to hire-purchase

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[1]Para. 13.11(i) of the said Study Group's Report.

[2]Please also see para. 2.22 of the Report of the Study Group on Non-Banking Companies (1975) appointed by the Reserve Bank of India.

[3]The suggestion made by Shri T. S. Santhanam, Chairman, South India Hire-Purchase Association, Madras, before the Joint Select Committee to amend the definition of "owner" in the Hire-Purchase Bill to specifically include "financiers of new and second-hand vehicles" also emphasises the notional and fictional concept of "owner" in hire-purchase financing, and brings out his true character, that is, as a financier (*vide* page 61 of the Select Committee's evidence).

finance companies from the operation of the general rule which the Study Group has recommended, namely, that no non-banking financial company should be allowed to deal, directly or indirectly in buying or selling of goods except in connection with the realisation of security given or held by it.[1] Were the hire-purchase agreement to be considered in its true form, that is, as a secured transaction, there would not be any need for such exception.

OTHER PRACTICAL DIFFICULTIES UNDER THE OWNER-HIRER CONCEPT

1.3.59 We may now refer to some of the other practical difficulties felt by reason of the retention of the owner-hirer concept. In this context, we may refer to the following aspects, namely

(i) the right of banks and hire-purchase financing institutions to take possession of the security in the event of default;

(ii) the priority rules applicable to the claims of banks and other financing institutions vis-a-vis the claims of hire-purchase financing institutions while providing instalment credit;

(iii) the availability of the priority on the basis of security interest for purchase money to both classes of instalment credit providers;

(iv) the ability of the industry availing itself of instalment credit to get the benefits of development rebate depreciation, etc.;

(v) the application of the rule of snatch-back; and

(vi) the ability of the hirer to find working capital for running the machinery or vehicle acquired by him by way of instalment credit.

Now, we may advert to them seriatum.

(I) *The Right of Banks and Hire-Purchase Financing Institutions to take Possession of the Security in the event of Default*

1.3.60 By reason of the application of archaic rules developed at a time when instalment credit did not assume its present economic significance, banks are now invidiously discriminated also in the matter of enforcement of their security interest in the secured property. In Johar's case, the Supreme Court had occasion to consider the validity of the clause in the hire-purchase agreement enabling the hire-purchase financier to take possession of the motor vehicle in the event of default

[1]Report of the Study Group on Non-Banking Companies (1975) para. 5.50.

by the "hirer". While the Supreme Court justified this clause on the basis of the "owner" concept, it held that this right would not be available if the transaction were only a secured transaction (as "hypothecation" in favour of a bank against a motor vehicle undoubtedly is). The Supreme Court observed :

> "The first question that has been urged before us is that there was really one sale in the present case by the motor dealer to the intending purchaser of the vehicle and that the appellant was a mere financing agent of such person. ..... Now if the property in the vehicle had passed to the intending purchaser at the time of the hire-purchase agreement it would not have been open to the appellant to take possession of the vehicle or to insist on payment of arrears or to become entitled to everything that had been paid upto that day. Under the law all that the appellant would have been entitled to was to realise the loan he had given by filing a suit and then attaching and selling the vehicle."[1]

Since the right to take possession without recourse to civil suit is traced to the inherence of "ownership" in the hire-purchase financier, this advantage is not now available to banks. Since the option is only of a superficial value and is not generally contemplated to be exercised by the hirer otherwise than by deciding to buy, there is no reason why we should not look at *all* hire-purchase transactions in their substance, that is, as secured transactions and statutorily give the power both to banks and hire-purchase financing institutions to take possession of the vehicle without recourse to courts. In effect, this requires that the status of "hypothecation" in favour of a bank should be elevated without affecting the right to take possession now available to a hire-purchase financing institution.

1.3.61 The fact that a financing institution has a right to take possession of the vehicle or the goods does not necessarily mean that this right could be enforced in all cases. Even when the institution lends on hire-purchase terms (under "owner"-"hirer" concept), this is the position. In Nawab Raza *v.* Emperor[2] it was held that though the "owner" had a legal right to recover the vehicle through the civil court he had no right to recover through the use of force and that the servants of the hirer did not form an unlawful assembly but were legally justified in resisting the attempts of the owner to recover possession of the vehicle through forcible means. It is in view of this that the Study Group on Road Transport Financing has expressed

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[1]Messrs. K. L. Johar & Co. *v.* The Deputy Commercial Tax Officer, Coimbatore III, A.I.R. 1965 S.C. 1082, at para. 10.

[2]35 C.L.J. 340.

that the "owner's legal right to repossess a vehicle may not be an effective right, if it has to be enforced through judicial processes, and if the right of seizure is not automatic and within limits clearly recognised as such".[1]

1.3.62 It is in view of the above that a suggestion was made before the Joint Select Committee on the Hire-Purchase Bill that the statute should provide that the owner under a hire-purchase agreement should have the right "subject to any contract, to enter into the premises of the hirer or any other place where the goods may be, and seize the goods".[2] While the right to take possession in the event of default without recourse to judicial process may be recognised both for banks and hire-purchase financing institutions what further protection should be accorded were the debtor or the "hirer" obstructs peaceful retaking of the goods or the vehicle is a matter that requires separate and special consideration.

(II) *The Priority Rules Applicable to the Claims of Banks and other Financing Institutions while Providing Instalment Credit*

1.3.63 The major volume of hire-purchase transactions in our country relates to the financing of road transport industry. Though ordinarily successive charges with reference to motor vehicles are not created, conflicts do arise between two or more persons trying to enforce their claims against the same vehicle. There may be a hypothecation deed with a bank, and a hire-purchase agreement with a hire-purchase financing institution in respect of the same vehicle. The hirer-borrower may or may not be a company. The hire-purchase charge or the hypothecation charge may or may not have been registered under the Companies Act. Similarly, the endorsement in the registration certificate of the vehicle relating to the secured claim may or may not have been effected in the manner required under the provisions of the Motor Vehicles Act. It is a fact that we do not have clear-cut principles to resolve such priority rules. Now they are sought to be resolved mainly on the basis of the form of the agreement. This may ignore the substance of the transaction based on a rational analysis of the nature of the secured claim.

1.3.64 In fact, in Manasuba's case, since the hirer-borrower, who happened to be a company, did not act honestly in its dealings with the secured parties, conflicting secured claimants tried to enforce their

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[1]Para. 7.7 of the Committee's Report.

[2]Evidence of Shri T. S. Santhanam, Chairman, South India Hire-Purchase Association, Madras, given before the Joint Select Committee on the Hire-Purchase Bill (page 63 of Evidence).

claims against the same vehicles. There the company court had felt that it was not the proper forum for determining such priority questions. When banks and hire-purchase financing institutions extend credit for purchase money and their preferential claim against the secured vehicle is challenged, or *inter se* conflicts develop,[1] the law should ensure, if it is to be progressive and if it is to facilitate economic development that both banks and hire-purchase financing institutions extending credit for purchase money are treated alike irrespective of the form of the transaction having regard to its substance without confining itself merely to the form of the agreement. In Manasuba's case, with reference to hire-purchase agreements with an option clause, the court held that registration under section 125 of the Companies Act is not necessary where the "hirer" is a company, since the financier is the "owner". However, a hire-purchase agreement without this option clause is required to be registered. This unnecessarily risks the interests of a bona fide lending institution which may not be aware of the hire-purchase charge over the assets of the company, as such a charge will prevail against third parties bona fide dealing with the assets and for no fault of theirs since the hire-purchase financier has taken care to insert an option clause in the hire-purchase agreement.

(III) *The Availability of the Priority for Purchase Money Credit to Both Classes of Instalment Credit Providers*

1.3.65 In our country banks have come to be socially controlled, and major banks have also come under public ownership. A major objective of these measures has been to ensure that credit is given for credit-worthy purposes. Giving credit for purchase money for productive purposes is a vital economic function. Hence, banks and other financing institutions as also hire-purchase financing institutions which provide this vital developmental credit should be encouraged in giving this form of credit. But at the same time it is necessary to ensure that all such credit purveyors are treated alike when they give credit for purchase money. Because of historical reasons, banks and other financing institutions are now considerably handicapped vis-a-vis the lenders who give credit for purchase money in the "hire-purchase" form.

1.3.66 If the purpose of the credit is the basis of the priority, the discrimination with reference to the secured position of banks and other hire-purchase lenders loses merit. It is this recognition that has led to legislation, or recommendation for legislation in other countries for the conferment of priority to credit for purchase money, whether

[1]The likelihood of which is clearly brought out by the facts in Manasuba's case.

or not the security interest is obtained by an agreement called "hire-purchase" or by an agreement called "hypothecation". The substance of both forms of agreements is the same.

(IV) *The Ability of the Industry Availing itself of Instalment Credit to get the Benefits of Development Rebate, Depreciation Allowance, etc.*

1.3.67 The bulk of the instalment credit goes to the road transport industry. The Bombay High Court in C.I.T. *v.* Sarasanpur Mills Ltd.[1] and the Madras High Court in C.I.T. *v.* Sri Rama Vilas Service (Pvt.) Ltd.[2] have taken the view that development rebate is admissible on road transport vehicles though the vehicles could not be "installed" as plant and machinery. But the proviso to section 10(2)(VIb) of the Income-tax Act introduced by the Taxation Laws (Amendment) Act, 1960 has withdrawn this relief. The Study Group on Road Transport Financing (1968) chaired by Shri R. G. Saraiya recommended, after considering the possible reasons for the withdrawal of the relief, the restoration of the relief of development rebate to the road transport industry. This Study Group referred also to the recommendation of the Road Transport Taxation Enquiry Committee to the effect that some relief from taxation should be given to the industry.

1.3.68 Apart from development rebate, depreciation allowance is another major fiscal concession which considerably influences the operational economics of the industries which rely on instalment credit. However, availing of the relief of development rebate and depreciation allowance when an industry gets instalment credit on hire-purchase terms is now subject to unnecessary complications which affect adversely the industry's ability to effectively avail itself of these concessions.

1.3.69 Technically, the depreciation allowance and development rebate are allowed to an *owner* in respect of the machinery or other assets employed by him in his business. With reference to machinery obtained on hire-purchase basis and employed in a hirer's business, the hirer is not entitled to claim depreciation allowance and development rebate as he is not the "owner". Since the machinery is not employed in the business of the "financier", the financier is also not in a position to claim these benefits. The net result would be that these valid tax concessions given for the growth of the industry in which the hirer is engaged are not utilised and to this extent the industry suffers.

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[1]A.I.R. 1960 Bom. 218.

[2]A.I.R. 1960 Mad. 224.

1.3.70 However, the Income-tax Department seems to have taken a practical attitude and has been trying to give the benefit of depreciation allowance and development rebate to the hirers. But the Madhya Pradesh High Court has pointed out in Sardar Tarasingh *v.* Commissioner of Income tax, M.P.[1] that "the directions issued by the Department for the guidance of its officials cannot control or affect the meaning or construction of the provisions of the Act". The instructions were construed by the High Court as dealing only with the method of calculation of depreciation allowance. In this view, that High Court has held that for claiming depreciation allowance in respect of an asset, as the assessee must be the owner, the hirer under the hire-purchase agreement cannot claim the benefit of depreciation allowance. Under the circumstances, the Public Accounts Committee has rightly taken exception to the Department's instructions which have been commented by the Madhya Pradesh High Court.

1.3.71 Were the transaction viewed having regard to the substance of the arrangement, whether there be an option clause or not in the hire-purchase agreement, there would be no difficulty in the hirer claiming the benefit of the development rebate and depreciation allowance to the full extent, wherver admissible.

(V) *The Application of the Rule of Snatch-Back*

1.3.72 We have earlier referred to the fact that the owner-nirer concept has given rise to considerable abuses by the hire-purchase financiers in the exercise of their right of "snatch-back". This led to the intervention of legislation to protect the interests of hirers. The Study Group on Non-Banking Financial Intermediaries set up by the Banking Commission has said that "high rates of interest charged or *forcible repossession* of vehicles for which hire-purchase finance had been extended usually characterise the operations of the smaller" hire-purchase financing units.[2] (emphasis added).

1.3.73 When we look at a hire-purchase transaction in substance, that is, as a secured transaction, a number of evils that are noticed by reason of the unscrupulous exercise by the hire-purchase lender of his right of "snatch-back" on the basis that he is the "owner", are automatically put an end to. If the motor vehicle is repossessed, by the secured lender, who has entered into an instalment credit agreement, which may be termed "hire-purchase", the disposal of the vehicle has to be in a commercially reasonable manner and the secured party shall be liable to account to the debtor for the proceeds of disposal in

[1](1963) 47 I.T.R. 756.

[2]Para. 4.9 of its report.

the view taken by our Supreme Court in Sundaram Finance case that the whole relationship is merely that of a secured creditor and a debtor who is given credit for the purchase money. Should there be any surplus, it should be due to the debtor who is termed "hirer".

1.3.74 In fact, the evidence collected by the Committee indicates that there is no forfeiture in practice by established hire-purchase finance companies and hire-purchase financiers, and that when a vehicle is disposed of, the money due from the hire is set off against the sale proceeds and the balance is paid to the hirer. It is possible that in tune with the cloak given to the transaction, such payment may be termed "ex-gratia".[1] But the real motivation for such payment is a recognition of the true nature of the transaction.

(VI) *The Ability of the Hirer to Find Working Capital for Running the Machinery or Vehicle Acquired by way of Instalment Credit*

1.3.75 By reason of the application of the ownership concept, the hirer, who may be a small trader or a businessman, may often find himself without any means to raise funds for his working capital requirements. If we take the case of a truck operator, he will be requiring periodical credit, though of small quantum, to meet the cost for the substitution of tyres, petrol charges payment to drivers, etc. It is common knowledge that most of the operators are owning one, two or three vehicles and they always borrow funds frequently for payment of tax, purchase of tyres, replacements, periodical fitness certificate jobs, etc. If it is a case of a secured transaction like hypothecation, the borrower will be in a position to raise some small amounts from other sources, without prejudice to the interests of the lending institution, if not from the same institution.

1.3.76 Where the hire-purchase financing institution has given the vehicle under a hire-purchase agreement containing an option clause, the hirer cannot even raise a small amount for meeting urgent and periodical expenses which are absolutely necessary in days when his business may be slack or it is running without any margin. Under such circumstances, there is no reason why small business people should be unnecessarily put to hardship and deprived of some means

[1]Even under the Hire-Purchase Act, 1972 which proceeds on the basis of the "owner-hirer" concept, the right of the hirer is recognised to claim a refund of the excess that may be determined in accordance with the formula laid down in the Act [section 17(1)]. On the basis that a hire-purchase transaction is really a secured transaction, the formula to be applied to determine what should be reckoned as the excess or the surplus would require further consideration.

which they would have for raising their working capital, had the arrangement been really understood in its real sense, that is, as a secured transaction.

1.3.77 What is important is that the hire-purchase financing institution's charge or the bank's charge should not be affected by any small subsequent credit which the "hirer" may be in a position to obtain to meet his working capital needs. Such means are denied to him unnecessarily and this affects his ability to establish himself in business.

THEN, WHY "OWNER" CONCEPT?

1.3.78 The fact is that even in the typical hire-purchase agreement with an option clause the transaction does not cease to be a secured transaction. While the courts are aware of this, the reason why the owner-hirer concept is still retained in the typical cases where this clause is present has been explained by Diplock, L.J., when he observed:

> "Hire-purchase finance companies cannot eat their cake and have it. If they choose to conduct their business by entering into contracts of hire of chattels, instead of entering into moneylending contracts secured by chattel mortgages, their legal rights will be covered by the terms of the contracts into which they enter and by the general principles of law applicable to contracts of that nature."[1]

Thus, the logic of this concept rests on the basis of the form the parties to the hire-purchase agreement have adopted. This logic is equally valid where the hire-purchase agreement provides for no ultimate exercise of "option" by the "hirer". In Sundaram Finance case[2] Subba Rao, J., who delivered dissenting judgment validating the agreement as evidencing instalment sale, has based his decision on the intention gathered from the terms of the agreement entered into in the hire-purchase form. He has observed :

> "Both the financier and the customers with open eyes entered into the transactions of hire-purchase, their intention was expressed in clear terms. They could have executed hypothecation bonds. but they did not, and instead entered into hire-purchase transaction.....They were, therefore, bound by the terms of the agreement."

Though here Subba Rao, J., has mentioned that there was no reason to camouflage the real nature of the transactions, we have earlier pointed out how the finance houses in the U. K. took recourse to

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[1]Financings Ltd. *v.* Baldock, (1963) 2 Queen's Bench 104, C. A.

[2]A.I.R. 1966 S. C. 1178, para. 7.

hire-purchase form while giving instalment credit in order to avoid the application of the provisions of the Bills of Sale Acts and the Moneylenders Acts. In an appraisal from the point of view of the U.K. finance houses, R. G. Kirkpatrick and Basil Greene have shown that "the fact of the matter is that the finance houses were forced by archaic and totally unsuitable legislation into adopting the legal fiction of hire-purchase" and that "the business of instalment finance has grown and prospered over recent years in spite of the handicaps imposed by an archaic legal structure".[1]

SUMMING UP

1.3.79 To sum up, the theory of instalment sale is now recognised in our country only where the hire-purchase agreement provides an option to the hirer to repudiate the purchase, that is, the type of transactions considered by the Supreme Court in Johar's case.[2] Viewing a hire-purchase transaction as an instalment sale artificially colours the transaction. The development of the hire-purchase form was peculiar to the circumstances that prevailed in the U. K. They have no direct application to our country. Even in the U. K., the Crowther Committee has recommended that the legal notion of instalment sale should disappear. There is similar recognition in other countries of the Commonwealth where hire-purchase form of financing is in vogue. In view of the need to rationalise our legal infrastructure we could justify our dispensing with the notion of instalment sale (which is in anti-thesis to the theory of "instalment credit"). In the field of hire-purchase financing, there are also other substantial and positive advantages which accrue, on such rationalisation, by the elimination of the following drawbacks :

(1) Adherence to the theory of instalment sale unnecessarily adds to the *cost of credit* flowing through financing agencies by necessitating a three-tier system for providing instalment credit even in areas where we do not have competent and well-managed hire-purchase financing institutions;

(2) Adherence to instalment sale concept in the field of hire-purchase adds to the various difficulties experienced by banks and referred to by the Study Group on Non-Banking Financial Intermediaries set up by the Banking Commission:[3]

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[1]"The policies of instalment credit law — An appraisal from the point of view of finance houses by R. G. Kirkpatrick and Basil Greene", Instalment Credit edited by A. L. Diamond, The British Institute of International and Comparative Law, Stevens & Sons, 1970, pp. 41-42.

[2]A.I.R. 1965 S.C. 1082.

[3]Report of the Banking Commission's Study Group on Non-Banking Financial Intermediaries, para. 4.12.

(3) Instalment sale concept comes in the way of banks effectively becoming prime lending agencies for instalment credit even in areas or in fields where banks possess the necessary expertise;

(4) While the theory of instalment sale affects banks from effectively becoming prime providers of instalment credit, it distorts the true role of a non-banking financial intermediary, like a hire-purchase financing institution, by depicting the same as a trading concern ;

(5) Instalment sale concept affects the ability of the industries availing themselves of instalment credit from getting the full benefit of the fiscal concessions, like development rebate, depreciation allowance, etc., that may be extended by Government;

(6) Instalment sale concept affects the ability of a small borrower or a hirer-businessman to find working capital for running the machinery or the vehicle acquired by him on instalment credit ;

(7) Instalment sale theory perpetuates the right of "snatch-back" by the "owner" though protective legislation may try to restrict the unfettered exercise of this right ;

(8) Instalment sale concept subordinates the security interest of banks, which provide instalment credit, to even the interest created by an unregistered hire-purchase agreement, and it affects the ability of banks to take possession of the security without recourse to court; and

(9) Instalment sale concept deprives banks from claiming a preferential security interest for purchase money where the banks finance the acquisition of goods.

1.3.80 Thus, the theory of instalment sale has become anachronistic in the realm of instalment credit. In dealing with the instalment credit providers, particularly banks and other public financing institutions, we may have to ensure that the security devices adopted by these institutions, for providing instalment credit do not rank inferior to the rights and status now enjoyed by private hire-purchase financiers.

CHAPTER 4

THE FUNCTIONAL APPROACH—THE BASIS OF OUR NEW LEGAL FRAMEWORK

When banks and other financing institutions switch over from a security-oriented to a purpose-oriented approach under the scheme of credit planning, security has a necessary, but only a functional role Since the present legal structure is not the work of any conscious analytical endeavour to give security a role consistent with its purpose and function in a developing economy, it is not surprising that the present legal structure comes in the way of banks performing effectively their role as catalysers of economic development.

1.4.2 The different forms of security devices adopted by banks and other financing institutions in our country closely follow the devices developed in other Common Law countries. Hence, the basic defects of such security devices are also common to them. In order to rectify the defects and recognise the functional role of security, there is necessity for legislation. Many Common Law jurisdictions have enacted necessary legislation. In some countries. such legislation is expected very soon. Such legislation has become a matter of urgent necessity in our country since the inadequate legal structure now retards the scope for banks and other financing institutions effectively contributing to the development of the economy, particularly in the expeditious implementation of the economic programme of the Government.

A. GOVERNMENT'S NEW ECONOMIC PROGRAMME AND OUR CREDIT-SECURITY LAW

1.4.3 The new economic programme of the Government is centered on the Government's pledge for the removal of destitution within a definite time-frame of ten years. Government is committed to follow an employment-oriented strategy in which primacy is given to the development of agriculture, agro-industries, small and cottage industries, especially in rural areas. The Five-Year Plans are being focussed to promote an integrated rural development. As the Finance Minister, Shri H. M. Patel, has stated in the Parliament, "there is an urgent need to redirect our economic policies and priorities so as to

ensure that economic growth subserves the objective of speedy eradication of poverty and unemployment, and a progressive reduction in inequalities of income and wealth".[1]

1.4.4 In order to attain the Government's objective for promoting economic growth with an eye on employment generation and wide dispersal of employment opportunities, particularly in the rural areas, it is essential that our credit-security law should be simple, purpose and production-oriented, and should be adapted to the conditions and requirements of our country.

1.4.5 Mahatma Gandhi warned us long ago against the danger and futility of attempting to borrow or transplant the Western systems without adapting them to the conditions and requirements of our country. The present chaotic state of our credit-security law, particularly our personal property security law, is primarily due to the application of archaic principles and concepts of Common Law developed a century ago in Western countries, without considering the present day validity of those concepts with reference to our socio-economic objectives and the Government's aim to forge an egalitarian and productive rural-urban nexus

1.4.6 For instance, the strong pre-occupation with the situation of legal title is the major drawback of the credit-security laws in all Common Law countries. This has also been pointed out by high-powered Committees in the U.K., Australia and other countries. This strong pre-occupation with notions of property in the field of our credit-security law has come in the way of our developing a legal structure that will recognise the functional role of the security. Our inadequate legal structure comes in the way of persons without independent means availing themselves of credit for productive and developmental purposes. The defective legal infrastructure supports the tendency to ask for security which is *not* acquired with the credit and which involves the commitment of assets of units, and/or the undertaking of liability by persons, *not* themselves availing of the credit. In other words, banks and other financial institutions, in their anxiety as to whether under the present legal infrastructre they can obtain effective and easily enforceable security over the assets acquired with the credit and whether they can effectively and easily enforce their rights on the assets of the units availing of credit, are tempted to ask for excessive security. This tendency also ignores the functional role of security. Again, this approach adds to the cost of the credit. And thereby the cost of production, procurement and distribution of essential commodities goes up.

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[1]Finance Minister, Shri H. M. Patel's speech in the Lok Sabha, delivered on 28th March 1977.

1.4.7 Fictitious property concepts[1] have affected the development of our road transport industry. When it is recognised that there should not be any unnecessary restrictions on road transport industry, we may have to reform or instalment credit law to remove the handicaps faced by the road transport industry by reason of archaic and artificial notion. This would involve that we should either do away with the theory of instalment sale in the field of instalment credit or we should give banks and other financing institutions the status and rights which are in no way inferior to the status and rights now enjoyed by private hire-purchase financiers. We saw earlier how the theory of instalment sale in the field of instalment credit makes an invidious discrimination against banks and other public financing institutions.

1.4.8 One of the inhibiting factors coming in the way of banks making better adjustment to the changes in the social set-up and people's psychology is the archaic legal structure concerning our credit-security law. Hence, there is the urgency for modernising and rationalising our credit-security law. We will first see the role of security under our credit policy. Then we shall examine the type of legal famework that would be conducive for banks and other financing institutions implementing their credit policy objectives without unnecessary constraints attributable to the archaic notions.

B. ROLE OF SECURITY UNDER OUR CREDIT POLICY

IMPACT OF SOCIAL CONTROL AND NATIONALISATION

1.4.9 As the Study Group appointed by the Reserve Bank under the chairmanship of Shri Prakash Tandon to frame guidelines for follow-up of bank credit has pointed out, "nationalisation of the major commercial banks, following upon social control, called for a new policy. both for deposit mobilisation through accelerated branch expansion and for equitable disbursal of credit. The banking system was asked to adopt a new approach as a credit agency, *based on development and potential rather than on security only*, to assist the weaker sections of society and, later, to lend to the public sector also. Significant sectors of the economy, which were once outside the scope of bank lending have now been brought within its ambit".[2] (emphasis added). This Study Group has also pointed out that "the security-oriented system tended to favour borrowers with strong financial resources, irrespective of their economic function".[3]

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[1]For example, the fiction of "owner" and "hirer" under our hire-purchase law. Please see paragraph 1.3.44 supra.

[2]Paragraph 1.2 of Tandon Study Group's report.

[3]*ibid.*, para. 3.2.

REPORT OF THE NATIONAL CREDIT COUNCIL'S STUDY GROUP

1.4.10 The National Credit Council's Study Group No. 2 appointed in 1968 has pointed out the shortcomings of the prevalent system of lending to industry and observed that the security-oriented approach to lending has led to the over-financing of industry in relation to production trends as also with reference to inventory in industry. This Study Group has recommended that the banking system should finance industry on the basis of a total study of the borrower's operations rather than on security considerations alone.[1] The Study Group has also highlighted the fact that by the banker's fixation with security under cash credit lending system, diversion of bank funds was made possible.[2]

DIFFERENCE IN OLD AND NEW APPROACHES

1.4.11 The Reserve Bank's Study Group chaired by Shri Prakash Tandon, referred to earlier, has also pointed out that most banks in the past were primarily concerned with the safety of the funds lent and the keeping of the accounts in order rather than with the effective utilisation of the credit for the purpose for which the credit was allowed. But, commercial banks have now toned up their credit appraisal and follow-up procedures. The Tandon Study Group has recommended the steps to be taken by banks for effective follow-up of bank credit so that banks may be enabled "to get away from security-oriented lending to production-related credit with security serving a subsidiary but necessary role".[3]

EXCESSIVE SECURITY DISCOURAGED

1.4.12 In fact under the present scheme, the tendency to build up security in the shape of inventory, which is not essentially required for the use of the unit, is discouraged. Dealing with inventories, the Reserve Bank's Study Group on follow-up of bank credit has recommended that " 'flabby' inventory should not be permitted, and 'profit-making' inventory ought to be positively discouraged" and that "both are selfish and an inequitable and inefficient use of resources".[4] This Study Group has also recommended that "receivables not in tune with the unit's and its industry's practices should not be financed by the banker".[5]

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[1]Report of the National Credit Council's Study Group's report, para. 3.5.

[2]*ibid.*, paragraph 3.20.

[3]Tandon Study Group's report, paragraph 8.4.

[4]*ibid.*, paragraph 4.4.

[5]*ibid.*, paragraph 4.6.

PURPOSE-ORIENTED CREDIT—THE NEW ORDER

1.4.13 Thus, the stage has come in our country for commercial bank lending being determined on the basis of the purpose of the credit and not merely on the basis of safety of the funds and the availability of the security. In the new shape of things we have to see what necessary role security has to play. A consideration of this will naturally help in the structuring of a legal framework for transactions secured against personal property.

SOCIAL RESPONSIBILITY OF BANKS

1.4.14 When there is a shift from capital-intensive to employment-oriented technologies, as is aimed by the Government, it is obvious that a policy with such aim will also have a great impact in the field of credit. Banks and other public financing institutions have a great responsibility in disbursing credit pursuant to such policy. Our credit-security law should be conducive to banks and other financing institutions effectively discharging this responsibility.

ROLE OF SECURITY IN DEVELOPMENT FINANCING

1.4.15 Thus, under our economy both banks and other public financial institutions are to extend credit for productive and development purposes. A person's ability to offer security is only a secondary consideration for extending him credit.

SECURITY SERVES A FUNCTION

1.4.16 As stated in the report on the research project on "Credit and Security—The Legal Problems of Development Financing" sponsored by the Asian Development Bank and the LAWASIA,[1] "the nature of security in development financing is that it serves a *function* and is not found merely in a legal form".[2]

THE FUNCTIONAL USES OF SECURITY

1.4.17 As stated in this project report, legal security serves the purpose of requiring "both the lender and the borrower to make a serious evaluation of the risks involved. In this way the taking of security injects a sense of discipline and responsibilty into the activities of both of them. Furthermore, security affords the lender an opportunity to refinance loan protfolios in order to increase liquidity..... It is insurance against the possibility of changed circumstances falsifying the predictions of the feasibility study".[3]

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[1]Law Association for Asia and the Western Pacific.

[2]Page 12 of the report.

[3]*ibid.*, Pages 58-59.

C. FUNCTION OF CREDIT-SECURITY LAW UNDER OUR CREDIT POLICY

1.4.18 From our legal structure we may have to discard the archaic notions regarding security, which are coming in the way of development. At the same time, the legal structure should recognise the functional and beneficial uses of security. Under a scheme with such objectives, "the function of the law is to provide a system whereby it is possible to engage in intelligent financial planning, taking into account both the private profitability of the enterprise and the public responsibility of the developer. In particular it must allow the assets of the enterprise to be simply, inexpensively, efficiently, and comprehensively mobilised as collateral for the finance that is required".[1]

EACH SECURITY HAS A PURPOSE

1.4.19 In deciding between the different types of security, "each security must be considered in the light of the purpose for which it was created. The criteria... are directed specifically towards the purpose of development finance and to finance of no other kind".[2] Thus, the purpose of credit for purchase money is to enable the borrower to acquire the machinery or the motor vehicle which is to form the prime security. The purpose of credit against the hypothecation of crops is to enable the farmer to raise current crops. Likewise, in bank lending the different forms of security are generally related to the purposes for which credit is given.

1.4.20 The fact that a borrower is in a position to offer security not connected with such purpose of credit may not help in security playing its functional role. It should not be the policy of law to encourage the obtaining of such independent security which is unrelated to the purpose of the credit, though recourse to additional security may be permissible and feasible in special circumstances.

1.4.21 Hence, we may refer to the basic formalities which our credit-security law may have to provide to facilitate purpose-oriented disbursal of credit by banks and other financing institutions.

(i) CREATION OF THE SECURITY

1.4.22 As pointed out in the report on the research project earlier referred to, "the formalities relating to the creation of the security should in all cases be as simple and as cheap as possible, but should provide a permanent record of the transaction".[3]

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[1] *See* report on the research project, page 21.

[2] *Ibid.*, page 62.

[3] *Ibid.*, page 63.

(ii) REGISTRATION OF THE SECURITY

1.4.23 "Registration of the security should be essential as a form of public notification for the perfection of the security, except where public notification is adequately provided by other means. This, for example, is to be found when the creditor takes possession of the collateral to the exclusion of the debtor."[1]

1.4.24 "Any system of registration should, however, be simple and inexpensive and, in particular, should not require registration of all credit and security documents. All that third parties concerned with the borrower's title to the collateral need to know is that the title is encumbered, and the address of the lender from whom they can obtain further information. What should be registered therefore is not documents but the fact that the security interest arises from the documents. This can be achieved by a system of notice filing".[1]

(iii) PRIORITY OF THE SECURITY INTEREST

1.4.25 "Questions of priority of claims against the collateral should depend entirely on the time of perfection, that is, the time of registration or of taking possession. Priority should *not* be made to depend on questions of title to the collateral, nor on questions of notice, nor on artificial and non-functional distinctions based on the character of the borrower, nor on distinctions between law and equity, nor on distinctions based on the formalities needed to create the security."[2] (emphasis added)

VALID DISTINCTION BETWEEN "BANKING" AND "MONEY LENDING" INSTITUTIONS

1.4.26 Our credit-security law does not now distinguish between pure moneylenders and banks. Banks are now subjected to banking regulation scheme and moneylenders are governed by the money-lending legislation of different States. The scope and scheme of these regulations are radically different. While moneylenders are basically concerned with the safety of their funds and the return on them and they also have the choice to give or not to give credit to a person, by and large banks and other public financing institutions which are socially controlled and publicly managed are urged to extend credit provided the borrower's claim is for an eligible creditworthy purpose. Thus, there are basic differences in credit appraisal by moneylenders and in that by banks and allied financing institutions. Our credit-security law would serve better the needs of commerce, industry and

[1]Page 63, *ibid.*

[2]Pages 63-64 of the report on the research project.

trade and would catalyse development if it could recognise the special role of banks. For example, special recognition may have to be given to banks extending credit against trust receipts. Again, in the matter of perfection of security interests, in deciding about priority rules and in realising the security, the law may validly distinguish between banks and other public financing institutions, and private moneylenders.

D. NECESSITY FOR A COMPREHENSIVE STATUTORY SCHEME

1.4.27 Before we conclude on the necessity for a comprehensive statutory scheme which would recognise the functional role of security under our credit policy, we may keep in mind the basic defects of our present credit-security law so that the new legal structure we hope to develop may be free from such basic defects. As it is, the area covered by our personal property security law is very scanty touched by legislation and is bristling with decisions yielding conflicting ratios confounding the prevailing general confusion in this branch of the law.

1.4.28 The Crowther Committee of the U.K. has thus explained how judicial decisions have involuntarily contributed to rigidity and perpetuation of archaic rules :

> "To resolve a particular dispute so as to produce a just result, the court lays down a principle which in later cases is applied and extended to cover situations where the facts are entirely different. In the course of time, a detailed and increasingly rigid set of rules is developed and the *raison d'etre* of the original decision is consigned to oblivion beneath a mass of case law. If the merits of the first dispute had been the other way, the court might well have formulated the statement of principle quite differently, and the whole direction of the law in that area might have been altered."[1]

As that Committee has pointed out, the confusion arising on an application of the Common Law principles "has not been peculiar to England but applies to all common law countries".[2]

1.4.29 Since the area where changes are required covers almost the entire field of personal property security law. it is obvious that a comprehensive restructuring of the legal framework relating to our personal property security law is necessary. The present position

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[1]Report of the Crowther Committee on Consumer Credit (1971), Vol. I, para. 5.1.4.

[2]*Ibid.*, para. 5.1.5.

in our country in this respect is almost *at idem* with the position found in other Common Law countries before special legislation was promoted in such countries.

CROWTHER COMMITTEE'S ANALYSIS RE. DEFECTS IN THE COMMON LAW RULES

1.4.30 In the U.K., the Crowther Committee, appointed to go into consumer credit, reached the conclusion "that it is neither possible nor desirable to make recommendations affecting consumer credit without re-examining the general law concerning credit transactions and, in particular, security in personal property".[1] Having reached this conclusion, it has tried to answer the question "as to why the common law, which is said to represent the quintessence of reason, should have become so confused in its treatment of credit transactions".[2]

1.4.31 The Crowther Committee has shown that the defects of the Common Law Principles as regards credit-security law, as understood in the U.K., are mainly due to—

(i) a strong preoccupation with the situation of the legal title;

(ii) the fact that the evolution of Common Law rules concerning credit transactions has to a considerable extent been a matter of accident; and

(iii) the manner in which a principle of law is enunciated and influences subsequent decisions before the court.[3]

The above analysis is equally valid in our country.

LEGAL REFORM REQUIRED IN SEVERAL AREAS OF PERSONAL PROPERTY SECURITY LAW

1.4.32 We have earlier seen that our pledge-mortgage law presents several problems which may require legislation for their solution. We also saw that our law relating to hypothecation is ambiguous and has no proper legal base. There is a dire necessity to codify this branch of the law. We noticed that the law relating to fixtures in our country does not facilitate financing against machinery and other fixtures without recourse to avoidable and expensive steps. Our law regarding instalment credit is unnecessarily couched in an allegorical language and does not differentiate between consumer credit and

[1]Report of the Crowther Committee on Consumer Credit (1971), Vol. I, para. 5.1.1.

[2]*Ibid.*, para. 5.1.2.

[3]*Ibid.*, paras. 5.1.3 and 5.1.4.

business credit. Our security law now does not help to encourage credit for purchase money, unless a hire-purchase form is adopted. By looking at hire-purchase as a form of instalment sale and ignoring the substance of the arrangement, banks are precluded from directly providing credit for purchase money in the form of hire-purchase. When they provide instalment credit in the form of hypothecation, they are forced to take a position inferior to that a private financing institution which may have lent in the hire-purchase form. We also saw that our trust receipt law comes in the way of banks extending credit facilities to a wider section of the public, especially the small borrowers and small entrepreneurs. We also noticed that the present law does not give recognition to the special role played by banks and other financing institutions.

1.4.33 Legislation is thus necessary to remedy the unsatisfactory position in the law relating to advances against personal property by banks and other financing institutions. But should we tackle the several areas where the law is now imperfect, piecemeal, by ad hoc measures, or should we attempt to construct, on the lines successfully adopted in other countries, a comprehensive legal structure which would cover all forms of transactions against personal property, leaving out for the present only the special requirements of consumer credit ?

1.4.34 The attempt to have a hypothecation law, a pledge law, a trust receipt law, an instalment credit law and a law relating to fixture financing, each to have its own scheme, is not only an unnecessary exercise but will create several other problems and new technicalities.

1.4.35 Such a step would run counter to the underlying theme of a rational analysis of the necessity for security and its functional use. It is in the interest of credit planning that the security law and the security devices reflect the substance of the arrangement and do not distort the picture by reason of the inappropriate form that may be adopted, having regard to the economic function of the security.

E. NECESSITY FOR NEUTRAL TERMINOLOGY

1.4.36 The law relating to advances against personal property security now does not reflect, nor does it give any indication of, the purpose for which a credit is allowed. When we adopt neutral terms appropriate to all forms of security, without undue emphasis on the form of the secured transaction, purpose-wise analysis and purpose-wise utilisation of credit are facilitated. If credit-security law could employ terms which would give an indication of the purpose for

which credit has been given, e.g., "security interest for purchase money", "non-purchase money security interest", "current crop loan security", "security interest in fixture", "security interest in inventory", "security interest in documents of title to goods", etc., instead of engulfing all such advances under one classification, viz., "hypothecation advance", obviously the law will facilitate purpose-wise analysis of the credit. This, and the priority rules based on the purpose of the credit, will also facilitate the purpose-wise utilisation of credit. The adoption of neutral terms also contributes to the development of our credit-security law without the constraints of archaic property concepts.

CROWTHER COMMITTEE ON NEUTRAL TERMINOLOGY

1.4.37 Without such neutral terms, as the Crowther Committee of the U.K. has indicated, "the law would simply be perpetuating the artificial distinction between one type of security interest and another. New terminology is also important as a means of avoiding the use of existing terms of art carrying with them meanings and interpretations resulting from previous decided cases. For a modern personal property security law it is essential to be able to cut free from words that have acquired over the years a distinctive significance which might well run counter to the underlying principles and policies of the proposed new legislation."[1]

OUR DIFFICULTIES FOR WANT OF NEUTRAL TERMINOLOGY

1.4.38 We have seen earlier how the recourse to allegory in the field of instalment credit has been clouding the substance of the transaction and has been giving rise to considerable difficulties. If this is true with reference to hire-purchase form as a security device, the hypothecation advances granted by banks and other financing institutions are equally equivocal. As Justice Ameer Ali has felt, the use of the word "hypothecation" contributes to ambiguity and has to be avoided.[2] A charge on a fixture, a secured claim on a book debt, a charge over standing crops, and a security over existing and future property like inventory cannot all of them be adequately covered by the expression "hypothecation".

NEUTRAL TERMINOLOGY IN ARTICLE 9 SCHEME

1.4.39 In the U.S.A., a statutory scheme, which recognises the functional role of security, has been developed. This is found in Article 9 of the Uniform Commercial Code. As we will be referring

[1]Report of the Crowther Committee on Consumer Credit (1971), Vol. I., para. 5.2.10.

[2]Manmohan Mukherji *v.* Keerichand Gulabchand, I.L.R. 1935 (LXII) Cal. 1046.

to this scheme again later, we confine ourselves now to one major feature of this scheme, namely, its employment of neutral terminology in regulating secured transactions. Adverting to the new terminology adopted in Article 9, one of the authors of the Code observes that "Article 9 uses its own terminology, which may occasionally grate on the unfamiliar ear. The choice of new vocabulary was deliberate".[1] The Official Comment of the Code makes the point that "the selection of the set of terms applicable to any one of the existing forms (e.g., mortgagor and mortgagee) might carry to some extent the implication that the existing law referable to that form was to be used for the construction and interpretation of this Article. *Since it is desired to avoid any such implication, a set of terms has been chosen which have no common law or statutory roots*".[2]

(emphasis added).

CANADIAN EMPHASIS ON NEUTRAL TERMINOLOGY

1.4.40 In Canada, Ontario is the first province to adopt a personal property security law modelled on Article 9 of the Uniform Commercial Code. Though in the pattern of drafting and in allied matters of procedure the American practice has not been followed, still, the use of new terminology was considered as indispensable for a proper legal framework to govern secured transactions. Referring to this new terminology, Prof. Albert S. Abel has observed that Article 9 "uses a good deal of quite novel terminology and thus it scraps the old lore of conditional sales, chattel mortgages, pledges—for 'security interest'. That feature however was not merely acceptable to us— *it was welcomed as indispensable to the fresh look at the subject and its restatement in a way to rid it of the tangle of connotations which would have embarrassed use of the older terminology with its long accretion of judicial decisions and professional understandings*"[3] (emphasis added). As Prof. Abel says, "new words of art are words of a new art with a clarity of content which even the best of definitions sections cannot assure".[4]

NEUTRAL TERMS AVOID UNDUE RELIANCE ON TITLE

1.4.41 As we have seen earlier, decisions on questions with reference to secured transactions have been affected by technical concepts

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[1]Grant Gilmore, Security Interests in Personal Property, Little, Brown & Co., (1965), p. 301.

[2]Official Comment to section 9-105 of the Uniform Commercial Code.

[3]"Is Article 9 of the Uniform Commercial Code Exportable ? The Ontario Experience", Aspects of Comparative Commercial Law, Sales, Consumer Credit, and Secured Transactions, edited by Jacob S. Ziegel and William F. Foster, McGill University, Montreal, (1969), p. 292.

[4]*ibid.*, p. 292.

relating to the nature of interest in the property purported to be created under the different forms of security devices obtained by banks and other financing institutions.

1.4.42 For example, the distinction between a mortgage and a pledge of shares has been clouded by the question whether in terms of the security agreement what is passed on to the secured party is an interest in the property or a kind of special property. Ultimately this is left to be decided depending on the circumstances and facts of each case, eroding the concept of commercial certainty. While a hypothecation agreement is regarded as creating only an equitable charge and hence is liable to stamp duty as a simple agreement, mortgage of moveables under the Stamp Act attracts ad valorem duty. When a mortgage is created and when it amounts to only a hypothecation are not matters that would be clearly seen by bankers and their clients. As regards innocent parties dealing with the security, whether the transaction is termed a mortgage or hypothecation does not seem to really affect the question.[1]

1.4.43 Again, extending the doctrine of constructive possession also to a case where the security is left under the custody and control of the debtor has resulted in several problems. In a key loan advance, while effective control is left with the borrower, notional possession is left with the lending institution. This is also the position with reference to the type of arrangement considered in Nadar Bank's case. It is on this theory that in an import situation, legally the bank's claim is traced to the documents or the goods released against the trust letter. All these situations have been developed to meet particular difficulties. While these devices have had their utility, they have brought about additional problems in their wake. Protection of the rights of third parties, which a rational scheme requires, is not possible if a perfected security interest is allowed when the goods are left in the possession of the debtor without any procedure for registration of the interest. While in a trust receipt situation, for a limited period the bank's claim may have to be protected in public interest and on grounds of policy, this has to be an exception and not a rule which could be extended to all types of advances by all types of institutions.

1.4.44 We have also seen how with reference to a fixture the further difficulty is created, that is, whether or not the annexation to the land or the building is such to convert the fixture into an immovable asset requiring a special procedure for obtaining a mortgage on the land.

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[1]Please also see Mulla on the Transfer of Property Act, 1882, 5th edition, p. 380.

1.4.45 With reference to instalment credit, we have earlier noticed how recourse to allegoric language has contributed to the lack of clarity as regards the substance of the transaction.

1.4.46 In the new statutory scheme which should govern secured transactions in personal property, there is the need for reconciling the different questions as to priority, creation and enforcement of charge and other allied matters without going into technicalities as to whether or not under the security agreement an interest in the property passes, whether the transaction creates a special property or an interest in the property, etc. The new schemes of personal property security law developed in other Common Law countries have successfully avoided such complicated questions by adopting a neutral terminology.

THE NEUTRAL TERMS TO BE EMPLOYED

1.4.47 The general concepts of the new personal property security law are the terms, "secured party", "debtor", "security agreement", "security interest" and "secured property" (in short, "the property") A secured party and a debtor by entering into a security agreement, create a security interest in the property offered as security. A security may be either goods or document of title to goods or an instrument or it may be in the nature of an actionable claim or a general intangiable. The credit might have been given to secure an existing or a future advance or may also cover an existing as well as a future property of the debtor. The basic terms employed in the statutory scheme have to be defined.

1.4.48 While considering the Article 9 scheme, with reference to the neutral terminology and the general concepts. the Crowther Committee has observed that "Article 9 provides *a constructive approach to the problem of terminology in secured transactions*"[1] (emphasis added). That Committee has further observed :

> "The person advancing funds on security is known as the *secured party*, whether in form he is a conditional seller, an owner supplying on hire-purchase, a mortgagee or a pledgee. The person for whose benefit the funds are provided or a part of the price is left outstanding is termed the *debtor*, whether he is a conditional buyer, a hirer, a mortgagor or a pledger. The agreement, whether described as a conditional sale agreement a hire-purchase agreement, a mortgage or a pledge, is designated in the Code a *security agreement*; and the interest of the secured party a *security interest*. The security itself is termed *collateral*. It is

[1]Report of the Crowther Committee on Consumer Credit (1971), Vol. I, paragraph 5.2.11.

not limited to goods but covers all forms of personal property, including debts, rights under contracts and other intangibles. These terms are convenient and used throughout this section of our Report except that we have substituted for the word "collateral" the word "security", which will sound more familiar to English lawyers."[1]

Such new terms have been adopted in the U.S.A. and in several provinces of Canada and have been recommended for adoption in the U.K. and Australia.

1.4.49 Hence, on policy objectives, for furthering credit planning in our country and for the implementation of the new economic programme of the Government, it is necessary that the terminology that we adopt in our credit-security law is neutral so that it would not colour the real nature of the transaction from being readily perceived. Questions of preferences and priorities in the law of secured transactions should also be determined appropriately enough based on the substance and not merely on the form in which the loan agreement is couched.

NEUTRAL TERMS REQUIRE NEW UNDERSTANDING

1.4.50 Though the recourse to such neutral terms and basic concepts is very much necessary for credit planning and for rationally adjusting the rights of parties to a secured transaction and those dealing with the security, this would require that the bankers, their lawyers and the legal profession familiarise themselves with these concepts.

1.4.51 Even in the US.A., Canada and other countries, when such innovative terminology was first employed, banks and their lawyers did not take to it with readiness. Thus, Prof. Gilmore has said that "one of the initial difficulties which a beginning student of Article 9 confronts is that of mastering a foreign language to the point where he is able to think directly in the new language without constantly having to translate back into his own everyday speech".[2] Prof. Abel has pointed out that while adopting this new statutory scheme in Canada "there has been as indeed was to be expected a certain educational task in acquainting the bar which the new terminology and persuading them of its charms; but the game is distinctly worth the candle..... The new vocabulary was not indeed something

[1]Report of the Crowther Committee on Consumer Credit (1971), Vol. I, Paragraph 5.2.11.

[2]Grant Gilmore, Security Interests in Personal Property, (1965). Little, Brown & Co., Vol. I., p. 302.

peculiar to us as importers, for the terms were just as novel in their native land, the United States. In so far as they are a factor, they should operate for, rather than against, exportability".[1]

1.4.52 Hence, a suggestion that our statutory scheme to regulate our transactions secured by personal property should continue to employ such terms like hypothecation, pledge, mortgage of moveables, etc., will defeat the very object of giving security a functional role in our credit-security law. As we have seen earlier, the recourse to neutral terminology is necessary in public interest. Bankers and lawyers are not unskilled carftsmen. In tune with the necessities for change, they have remarkably assimilated and applied innovative techniques and new schemes for granting and disbursing credit. Even under the existing legal framework, with all its constraints, they have applied a lot of innovations, like the consortium arrangements and other modern techniques to effectively subserve the needs of economic development and promote growth. Hence, it is but natural to expect that the new concepts and the new terminology which are required to be employed, will also be assimilatd and applid by the bankers, banks' lawyers and clientele with expedition since the new terminology is being brought in only to expedite the handling of credit transactions and reduce, to the extent possible by legal reform, the time labour and cost involved in the granting of credit.

F. ADAPTABILITY OF ARTICLE 9 SCHEME TO SUIT OUR CONDITIONS

1.4.53 As observed in the report on the project study on Credit and Security—The Legal Problems of Development Financing, "in the search for a hypothec security over goods, the security system of Article 9 of the American Uniform Commercial Code is often held out as an example. It is true that Article 9 does solve most of the problems and avoids most of the difficulties that have been encountered in common law jurisdictions, although apparently not without raising fresh problems. It is, however, generally agreed to be the best we can do for the moment. It therefore poses the question of how far it is transportable."[2]

1.4.54 "It is probably true to say that Article 9 presupposes a common law system and a basis on sophisticated laws and legal, commercial, and administrative skills. It has been exported to

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[1]"Is Article 9 of Uniform Commercial Code Exportable? The Ontario Experience", Albert S. Abel, Aspects of Comparative Commercial Law, McGill University, Montreal, pp. 292-293.

[2]Page 74 of the report.

Canada, and its adoption in England and Australia also has been recommended. There is probably no reason why the scheme based on Article 9 but adopted to local conditions should not work in either of these countries or in Singapore. It is a model law, and the conditions for its successful transplant exist in these countries. The problem is much more acute, however, in civil law countries and in less developed countries."[1]

CROWTHER COMMITTEE'S VIEWS ON ARTICLE 9 SCHEME

1.4.55 The developments in the U.S.A. resulting in the adoption of Article 9 of the Uniform Commercial Code in all the states except Louisiana (which has adopted civil law jurisdiction) may be referred to by quoting what the Crowther Committee has said about this:

> "American lawyers were the first to recognise the extent to which sensible and proper commercial transactions were being undermined by these rigid and artificial rules of law. Commencing with the Uniform Trust Receipts Act, they set out to introduce greater flexibility and to strive for a legal framework which would accommodate commercial operations and would look to the substance and effect of the transaction rather than to the form in which it was cast or the situation of the legal title. These endeavours by lawyers and others in America ultimately found expression in the Uniform Commercial Code, and in particular in the revolutionary Article 9 regulating secured transactions in personal property. The Code, first promulgated in 1951 by the two sponsoring organisations, the National Conference of Commissioner on Uniform State Laws and the American Law Institute, is the outcome of years of intensive research, drafting and analysis. The purpose of the Code was to replace the numerous prior uniform enactments by a single statute which would modernise and unify commercial law in the United States. The Code, like other uniform enactments, does not itself have the force of law in any state except in so far as it is translated into legislation in that state. The adoption of the Code is purely optional and the state legislatures are free to make such variations as they consider appropriate. Variations are common, so that, whilst the broad structure and much of the detail are uniform, the Code varies somewhat from state to state. The latest text of the Code was published in 1962,[2] but the Code is under constant review by the Permanent Editorial Board, which from

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[1]Report on the project study on Credit and Security—The Legal Problem of Development Financing, pages 74-75.

[2]The latest revision of this Code is of the year 1972.

time to time recommends amendments. The Code has now been adopted by every state except Louisiana. This is a remarkable tribute to those responsible for producing it; and the widespread adoption of the Code appears to be due in no small measure to the outstanding merits of Article 9, which gave the common law world, for the first time, a comprehensive and rational legal structure for the regulation of security interests in personal property."[1]

TRANSPLANT OF ARTICLE 9 SCHEME IN CANADA

1.4.56 In Canada the Catzman Committee engaged itself with the task of preparing a version of Article 9 scheme which could be more easily understood by lawyers in Common Law countries. The Catzman Committee recognised that while there is special merit in the terminology employed in Article 9 with reference to basic concepts of the scheme, it felt that the draft legislation requires further refinement so that it is brought "to a form in keeping with local expectations".[2] The Catzman Committee had to work on this measure "continuously from the winter of 1960-61 until enactment of the bill in the spring of 1967" in Ontario.[3] For several years it met bi-weekly save for the summer months. All through the period of gestation, there was communication with the bar and other interested persons, official and unofficial, not only with individuals personally and by correspondence but through conferences, bar association meetings, meetings with legislative committees, Attorney-Generals' committees, the Law Reform Commission of Ontario and others".[3] This resulted in the enactment in 1967 of the Ontario Personal Property Security Act. Similar legislation has been enacted in Manitoba. In Saskatchewan the law reform commission has drafted a bill which follows substantially the Ontario legislation.

1.4.57 A committee of the commercial law section of the Canadian Bar Association has also taken up this project and that committee, chaired by Prof. Jacob S. Ziegel, has prepared a model Act for consideration and adoption by the Canadian provinces. This step

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[1]Crowther Committee Report, para. 5.1.5.

[2]"Is Article 9 of Uniform Commercial Code Exportable? The Ontario Experience", Albert S. Abel, Aspects of Comparative Commercial Law, edited by Ziegal and Foster, p. 294.

[3]*ibid.*, p. 291.

of the Canadian Bar Association has considerably helped in the adoption of legislation on this subject by the various provinces of Canada.[1]

ARTICLE 9 SCHEME IN COMMONWEALTH IDIOM

1.4.58 The Crowther Committee has felt that the Ontario Personal Property Security Act which is closely modelled on Article 9 "is of particular significance in that it represents the first attempt to transplant Article 9 into a common law country outside the United States"[2] As Prof. Abel says, the Canadian version is an "alternative model whose idiom is that of the Commonwealth rather than the United States".[3]

THE GERMAN VIEW OF ARTICLE 9

1.4.59 Appreciation on the scheme of Article 9 has been forthcoming not merely from Common Law jurisdictions but also from Civil Law countries, Prof. Ulrich Drobnig, Scientific Member, (*Max-planck Institute fur Auslandisches und Internationales Privatrecht,*) Hamburg, has highly appreciated the uniform concept of security interest developed in Article 9. As he says :

> "The greatest intellectual achievement of Article 9 is, I think, the distillation and application of a uniform concept of security interest, subject to certain *functional differentiations.* It comprises the possessory security device (the pledge), and the several non-possessory interests, like conditional sale, chattel mortgage, trust receipt, and assignment of accounts receivable. *It departs from title (ownership) as a vehicle for security devices—surely a blind and clumsy horse.*
>
> The concept of one security interest, with slight functional differentiations for its various forms, is highly original and fruitful. It will certainly influence German and European writers."[4]
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> (emphasis added)

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[1]The Canadian Model Uniform Personal Property Security Act is further being revised by a committee chaired by Prof. Jacob S. Ziegel. Another committee chaired by Mr. Fred M. Catzman of Toronto is revising the Personal Property Security Act of Ontario. But these revisions are only meant to make further improvement on the scheme, the basic features of which have already gained acceptance in all the Common Law provinces of Canada.

[2]The Report of the Crowther Committee on Consumer Credit (1971), Vol. I., para. 5.5.6.

[3]"Is Article 9 of the Uniform Commercial Code Exportable? The Ontario Experience", Aspects of Comparative Commercial Law, McGill University, Montreal, (1969), p. 294.

[4]"Is Article 9 of the Uniform Commercial Code Exportable? A German View", Aspects of Comparative Commercial Law, McGill University, Montreal, (1969), p. 370.

DEVELOPMENTS IN AUSTRALIA

1.4.60 In Australia the Rogerson Committee of the Adelaide University Law School, while going into the problems relating to consumer credit, has generally endorsed the recommendations of the Crowther Committee of the U.K. for reforming consumer credit legislation by a comprehensive scheme following the conceptual scheme in so far as it relates to security interests on the basis of the scheme incorporated in Article 9 of the Uniform Commercial Code. After the Rogerson Report, a committee chaired by Thomas Molomby has reported to the Attorney-General for the State of Victoria and it has proposed legislation in the State in tune with the developments in the U.S.A., Canada and the U.K. The Molomby Committee has also recommended a chattel securities Act which on conceptual analysis would be on the pattern of Article 9 legislation.

1.4.61 The Attorney-General of the Commonwealth of Australia, the Hon'ble R. J. Ellicott, has advised us that a committee is currently working on the preparation of draft uniform schemes for legislation, one for chattel security and the other for consumer credit. The draft Bills are expected to be ready shortly.

THE BASIC FEATURES OF THE NEW SCHEME

1.4.62 Now what is the chief merit of the Article 9 scheme? Why has it earned almost universal endorsement as regards its basic framework in the Common Law countries? The main merit of this scheme is to look at a secured transaction having regard to the purpose of the advance and its aim is to refashion the security laws with emphasis on the economic function played by the security so that there could be a stimulus for grant of credit in the directions where credit could contribute effectively to the development of the economy. The significance of this cannot be lost sight of when in our country we are veering round from a security-oriented approach to a purpose-oriented appraisal to determine the eligibility for granting credit.

1.4.63 If the theme of the law on secured transactions is the substance of the transactions and is not centred on the form or the nomenclature the parties may choose to adopt in entering into loan agreements, the economic and functional role of security will be better appreciated and the flow of credit into desired channels will be more ably safeguarded. Thus, the shift in emphasis from the form to the substance is necessary in the legal reform relating to secured transactions.

1.4.64 We can effectively provide for the shift in emphasis if in the legal infrastructure we are developing to deal with the granting of loans and advances by banks and other financing institutions, adequate scope is given for the law to recognise the purpose of the finance.

1.4.65 Following the recommendations of the Export Promotion Committee, the Reserve Bank of India had earlier proposed legislation on the lines of the Uniform Trust Receipts Act of the U.S.A. In the context of promoting trust receipt legislation, the Bombay Exchange Banks' Association obtained legal opinion which favoured a legislation on the lines of the American model to cover trust receipts and other equitable securities. Article 9 scheme is a development of the original scheme of the Uniform Trust Receipts Act and covers all security interests in intangible and tangible movable assets and fixtures. We have earlier seen the necessity for special legislation to cover trust receipt advances and in other areas of secured transactions by banks and other financing institutions. It is appropriate that Article 9 scheme serves as a model since it is a further and fuller development of the scheme which was found earlier as adaptable and necessary for our country in the context of developing our export trade.

1.4.66 For building up a legal infrastructure in our country, which would recognise the functional role of security, encourage production and purpose oriented disbursal of credit and enable banks and other financial institutions to bring about a shift in national assets and income distribution in favour of those in the priority and backward sectors, Article 9 of the Uniform Commercial Code of the U.S.A. provides us with a model scheme, which has worked successfully for the past several years in many jurisdictions. This scheme would also consequently eliminate many of the basic defects of our credit-security law, namely, its undue emphasis on the form rather than the substance of the arrangement, its strong preoccupation with the location of title and its link with archaic property concepts. Thus, a statutory scheme on the lines of Article 9 of the Uniform Commercial Code is necessary in our country, particularly in the wake of the new economic programme of the Government. But it is obvious that the scheme has to be oriented to suit the social and economic milieu of our country and subserve the economic and credit policy objectives of our country. Hence, while applying the broad basis of this scheme to our country we have to make appropriate adaptations.

G. BROAD BASIS OF THE NEW SCHEME

1.4.67 The new statutory scheme we have to evolve should recognise the functional role of security. It should distinguish a transaction based on the substance of the arrangement without undue emphasis

on its form. It should employ neutral terms which would highlight the substance of the security agreement. It should simplify and rationalise our credit-security law. In this effort Article 9 of the Uniform Commercial Code of the U.S.A., the comparable Canadian legislation and the scheme for legislation suggested for the U.K. and that for Australia could be looked into with advantage in structuring our credit-security law having regard to the substance of the arrangement. The scheme has to be so drawn up as to highlight national priorities and facilitate the flow of credit in desired channels. This requires that while we may benefit from the Article 9 scheme and the comparable legislation, we have to evolve our own scheme.

1.4.68 Having regard to the essential features for a sound scheme of credit-security law, earlier considered by us, we may try to indicate the main features the new scheme must provide for. Particularly, they would relate to the following :

(i) SECURITY AGREEMENT AND ITS FORMS

1.4.69 Any agreement which in substance creates a security interest in movable assets (including fixtures irrespective of whether the fixtures are regarded as moveables or not) should come within the scope of the statutory scheme. While the existing forms of security agreements, styled hypothecation agreements, pledge documents, trust receipt, hire-purchase agreements, etc., may continue to be employed until more precise and clear forms are drawn up by banks and other lending agencies, the rights of parties in material respects must be decided by the statutory scheme.

1.4.70 In order that the borrowers of banks and others may be aware that such a security agreement is to take effect only as provided in the statutory scheme, banks and other public financing institutions may be asked to stamp such an agreement form with the following legend :

> "This agreement will take effect subject to the provisions of the Personal Property Security Act, 197—"

1.4.71 Either we have to bring each and every hire-purchase agreement (barring hire-purchase of consumer durables) under the statutory scheme, whether or not there is an option provided in the agreement for the hirer to repudiate the purchase, or we should give banks and other financing institutions the status and rights which are in no way inferior to the status and rights now enjoyed by private hire-purchase financiers. The provisions of our Hire-Purchase Act, 1972 require to be suitably amended. The scheme of our credit-security law should also cover the leasing of property (moveables and fixtures) intended to act as security. Since book debts and other actionable claims obtained as security may take the form of assignment, the scheme

should cover also assignment of actionable claims and such other rights to intangibles. However, assignment for the general benefit of creditors may have to be excluded from the scope of the scheme.

(ii) GENERAL EFFECT OF SECURITY INTERESTS

1.4.72 For the security agreement to take effect (technically it may be called, "to attach"), the main criteria should be the time when the debtor gets rights in the property offered as security and the presence of consideration. As between the secured lender and the debtor, the terms of the agreement should oridinarily be enforceable. But third persons' claims on the security should be subordinated only when they have actual or constructive notice of the security interest claimed under the security agreement.

1.4.73 Possession of, or effective control over, the secured property may have to be with the secured party in order to subordinate the claims of third parties to those of the secured party. The circumstances when the goods are either covered by a document of title to goods issued by a bailee or for a temporary period when the goods are covered by a trust receipt issued by a bank could be valid and justifiable exceptions to this rule. In all other cases, there should be such method of registration provided for as the circumstances of each case would admit. A security interest claimed under a security agreement (by whatever name called) and covering goods in the possession of the secured party or in respect of which registration in the manner provided has been effected, should be regarded as a perfected security interest. Such a perfacted status should also accrue to a security interest covered by a trust receipt advance granted by a bank, and to an advance against a document of title to goods deposited with the secured party.

1.4.74 While the general rule should be that a perfected security interest should prevail over the claims of third persons for an interest in the goods offered as security, there may have to be valid exceptions to cover cases, like the buyer of goods in the ordinary course of business purchasing from a retailer whose inventory is covered by the security agreement. Such exceptions are not many and could be taken care of in the statutory scheme.

(iii) PERFECTION AND REGISTRATION

1.4.75 In the majority of cases, the usual method for perfection of a security interest would be by registration. The necessity for a simple, inexpensive and easily accessible registration machinery for the development of our credit-security law with its theme as the substance of the secured transaction is paramount. At the same time, having regard to our technological development, it may not be

feasible to go in straightaway for a computerised scheme for registration of security interests in personal property. For the development of an adequate registration machinery, we may have to plan our requirements in two stages.

1.4.76 As a long-term perspective, a computerised registration system providing for central and notice filing of security interests is the ideal one. Its implications may have to be examined and carefully worked out. However, the available apparatus for registration of security interests in the assets of different classes of debtors will have to be put to maximum use as immediate as practicable in order that our credit-security law which recognises the functional and economic role of security can be brought into force with expedition. Hence, immediate attention need be focussed only on the development of a registration machinery from the available administrative and legal set-up.

SECURITY INTERESTS IN COMPANY'S ASSETS

1.4.77 At present, administrative and legal set-up exists for registration of charges over the assets of companies. With appropriate modifications, this set-up should be put to optimum use to support our credit-security law.

SECURITY INTERESTS IN ASSETS OF FIRMS AND PROPRIETARY CONCERNS

1.4.78 With reference to firms and sole proprietary concerns, we do not have any administrative and legal set-up which could readily take up the function of serving as a medium for the registration of security interests in their assets. Hence, there is the urgency for developing an administrative and legal set-up to provide for registration of security interests in the assets of firms and proprietary concerns. There are obvious administrative and practical problems which may have to be tackled before we could develop such a set-up. The forum of the Registrar of Firms and that of the Registrar of Assurances are the possible venues which could be utilised for this purpose.

1.4.79 The existence of quite a number of unregistered firms and the fact that the Registrar of Firms may not be an effective agency come in the way of the utilisation of the machinery of the Registrar of Firms for the registration of security interests in the assets of firms. Again, partnership firms and sole proprietary concerns are in several respects allied both in juridical concepts and in the nature of their functioning. The Registrar of Firms cannot evidently cover both firms and proprietary concerns.

1.4.80 Under the circumstances, we are left with the Registrar of Assurances. The Registration Act, 1908, does not require compulsory registration of charges over movable assets. But it does

provide for their optional registration[1] though it is now rarely done. But before the administrative machinery available with the Registrar of Assurances could be utilised with reference to security interests in movable assets and fixtures, we should ensure that the expensive and time-consuming formalities now applied with reference to registration of documents for security interests in land are not applied to the registration of security interests in goods and machinery belonging to firms and proprietary concerns.

1.4.81 In other words, a simple method of *notice filing* and a separate register showing such filed interests which would be available for inspection by the public may have to be provided for. Again, in order that the work on account of the registration of security interests in moveables and fixtures of firms and proprietary concerns does not lead to insurmountable pressures in the office of the Registrar of Assurances, it is necessary to specify —

(a) that, for secured parties filing with the Sub-Registrars, notification containing particulars of their security interests may be sent through registered post;

(b) that even without such notification, banks and other public financing institutions could enforce their security interests as perfected security interests (in other words, want of such notification by banks and other financing institutions should not affect the enforceability of the security interest though it may affect their priority); and

(c) that the place where the firm or proprietary concern carries on business (or where it has the Income-tax Permanent Account Number) shall be the appropriate place for registration.

Fixtures and motor vehicles

1.4.82 With reference to fixtures and motor vehicles, we may have to continue with appropriate modifications the registration machinery now available. In other words, though for the creation of a security interest and for the determination of rights and priorities a fixture should be regarded as a movable property under our credit-security law, yet we should provide that it should be so registrable with the Registrar of Assurances in a separate register which he may maintain for this purpose and wherein particulars relating to the land or the building in which the fixture is installed or annexed will also be noted and made available for registration. Registration should mean a mere notice filing and the appropriate place for registration should be the place where registration is required to be made of an interest in the land to which the fixture is, or is to be, attached. The register should be available for inspection by the public.

[1]Section 18(d) of the Act.

1.4.83 The certificate of registration as regards a motor vehicle now provides for endorsement therein of a security interest in favour of a hire-purchase financier. A person claiming an interest by way of hypothecation can also have his interest noted in the certificate though, as we earlier pointed out, as regards the rights over the motor vehicle, the hire-purchase financier and the hypothecatee are differentiated. Since both are providing instalment credit for purchase money, both their interests would require mention in the certificate of registration and the existing discrimination which operates to the prejudice of banks in the matter of their rights over the vehicle should also be eliminated.

(iv) PRIORITIES

1.4.84 Want of registration, as we mentioned earlier, should not affect the validity of the security interest. It may affect priorities and may be a legitimate factor to be considered where the genuineness of the agreement is in question. Subject to this, the law should recognise both unperfected and perfected security interests. The legal distinction now made with reference to legal and equitable charges (such as "mortgage of moveables" and "hypothecation of moveables") has no practical value. As a general rule, in the case of perfected security interest priority should be determined by the order of registration or perfection. The date of attachment of the security interest should be relevant for determining priority only when there is no conflicting perfected security interest.

Banks' advances to firms and sole proprietary concerns

1.4.85 Where a security interest is claimed in the assets (other than a fixture or a motor vehicle) of a firm and proprietary concern, a bank's claim should be protected over the claim of any unsecured creditor including the claim for Government dues. Such protection should also be available in the event of insolvency. These provisions are necessary to place on a proper and sound basis the advances by banks and other public financing institutions to firms and proprietary concerns. As regards fixtures and motor vehicles, there is no necessity for such special treatment.

Purchase money credit

1.4.86 Purchase money security interest in the field of instalment credit merits special recognition. This should rank in preference to a general security interest claim against the assets of the debtor. Such security interest may inure to the benefit of both hire-purchase financiers and other categories of instalment credit providers like banks and other public financing institutions.

Current crop loans

1.4.87 The rural bias of our economy needs no special mention. Credit for agricultural sector merits adequate recognition. In the field of our credit-security law, this could be truly reflected by a priority given in favour of banks and other public financing institutions providing credit for the raising of current crops. This preference should be available *independent of any consideration as to whether or not the cultivator has an interest in the land.* The preference in favour of current crop loans should also cover advances given at or before the sowing season for the raising of crops.

Advances against machinery

1.4.88 There have to be clear rules for reconciling the claims of a person having an interest in the land and those of another having an interest in the machinery annexed to the land or the building on the land. We have earlier noticed the unsatisfactory position of the institution lending against machinery meant to become a fixture. The commercial bank which has financed the acquisition of the machinery should have the preference over such fixture, and rules will have to be made for having its security interest properly enforced without affecting the general interests that may be claimed by a term lending institution in the land and the building or the factory.

Accessions

1.4.89 Opportunity should be availed of to have appropriate priority rules with reference to accessions on lines similar to the priority rules laid down for fixtures. The desirability of such rules has been pointed out by the Crowther Committee for the U.K. Our scheme should also provide for this.

Commingled goods

1.4.90 Warehousing business would develop and agricultural sector would benefit considerably were our law to provide for bulk warehousing and documents being issued regarding fungible portions of commingled goods. The current crop produced in a village can be bulk-stored and the cultivators can be issued documents of title by the warehousemen; these documents need not cover earmarked bags but may indicate the quantity stored by the particular individual and comprised in the total warehoused bulk. The necessity for developing our warehousing facilities has been stressed by several bodies and the provision providing for reconciliation of the rights with reference to the commingled goods which may be bulk-warehoused and which may be covered by the issue of documents of title covering fungible goods has special merit having regard to the rural and agricultural bias of our country.

(v) RIGHTS AND REMEDIES ON DEFAULT

1.4.91 While on the subject of rights and remedies consequent on default, we have to keep in view two fundamental factors which are of common experience. Realisation of security through judicial process is very expensive and time-consuming. If the funds of banks and other public financing institutions are looked up, other eligible and creditworthy purposes are starved of credit in a period of credit scarcity. Hence, the law should provide for the realisation of dues of banks and other public financing institutions by recourse to the security as far as possible *without judicial intervention.* The necessity for this is very much apparent as regards these credit purveyors.

1.4.92 Where the lending agency is *not* a bank or other financing institution, there is the possibility of the secured party acting somewhat arbitrarily in enforcing its rights over the security. This possibility is all the more so when such an agency claims an unperfected security interest. Hence, *unperfected* security interests claimed by persons other than banks and other public financing institutions should be enforced only through judicial process.

1.4.93 The statute should also clearly provide for the steps to be taken and the procedures to be adopted by the secured party while realising his dues by enforcement of the security.

(vi) CLASSIFICATION BASED ON NATURE OF SECURITY

1.4.94 Having regard to the nature of the security, the personal property security law will have to make appropriate distinction in laying down the rights and duties of the parties to a security agreement and those of third parties dealing with the secured property. For instance, security interest claimed in a future property and that in a fixture cannot be equated. Likewise, security interest in consumer goods would merit special treatment. Negotiable instruments and documents will have to be distinguished from the non-negotiable. An appropriate classification of property offered as security is necessary for our personal property security law.

(vii) RULE MAKING POWER OF GOVERNMENT

1.4.95 The Central Government should be the appropriate agency which could watch the enforcement of the statutory scheme. The Government should be enabled to frame rules for the proper functioning of the various registration authorities coming within the ambit of the personal property security law. The Government should also be empowered to pass orders and make necessary rules for the removal of any doubts and for resolving any difficulties experienced in the operation of the statutory scheme.

PART II

SECURITY-WISE ANALYSIS AND THE PROVISIONS FOR REGISTRATION AND REALISATION


सत्यमेव जयते

CHAPTER 1

INTRODUCTORY

In Part I of this Report we saw the present chaotic state of our personal property security law. We also noticed the necessity for a comprehensive scheme of legislation in the field of our personal property security law, particularly, to enable banks and other financing institutions play an effective role in the socio-economic development of our country. We also outlined the broad framework of the conceptual scheme that should govern such a scheme of legislation. In this process, we saw why it is necessary to rid our personal property security law of archaic notions of property and, as a part of this, we felt the necessity to dispense with the concept of instalment sale.

2.1.2 While the broad framework of the statutory scheme for personal property security law has been set out in Part I, in this Part we will go into the special provisions that should form part of such a comprehensive statutory scheme. As we noticed earlier, the scheme will recognise the functional role of security and questions of priority will be solved and reconciliation of conflicting claims effected in a manner that will encourage the production and purpose oriented credit. In this context, we also find the necessity for discriminating between credit for purchase money and other forms of credit.

2.1.3 The Committee's consideration of the provisions of the draft Bill can be classified under the following major heads :

(1) special rules with reference to purchase money credit, particularly instalment credit for purchase money;

(2) credit against fixtures and accessions;

(3) credit against actionable claims and other general intangibles;

(4) special protection to banks;

(5) registration machinery under—

(a) the Companies Act,

(b) the Registration Act, and

(c) the Motor Vehicles Act; and

(6) rights, obligations and remedies of parties.

In the following chapters we set out the main features and provisions of the scheme under the above heads.

2.1.4 The text of the Bill (together with notes on clauses) recommended by us is given in Part IV of this report. The necessity for such a legislation has been fully brought out in our discussion in Part I. There we explained the requirements for our developing economy. But here we will only add that the enactment of such a legislation would also be fulfilling a need considered as overdue for the past several decades.

2.1.5 Sir Rashbehary Ghose long ago, in his Tagore Law Lectures, regretted the absence of legislation on the subject of hypothecation of moveables. He hoped that some day the Indian Legislature would have leisure to take this question on hand[1]. We also find that, in drawing up our registration scheme, the framers of the Registration Act, 1908, had in mind the ultimate development of the scheme to cover also registration of charges over moveables on a compulsory basis, instead of the same being allowed on an optional basis as is now the position.[2] Thus, the enactment of the statutory scheme on personal property security law will be the logical, natural and fuller development of our credit-security law.

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[1]"The Law of Mortgage in India", Tagore Law Lectures (1875), Thacker Spink & Co., Calcutta, 5th edn. (1922), pp. 115-116.

[2]Section 18(1)(d) of the Registration Act, 1908.

CHAPTER 2

PURCHASE MONEY CREDIT

Credit for purchase money, which is production oriented, requires all encouragement having regard to its significance for the economic development of our country. It is not surprising that purchase money security interest has been given a preferential status *vis-a-vis* other forms of credit in the credit-security laws of developed countries. Instalment credit for purchase money is adapted to the needs of the road transport industry and the financing of the acquisition of machinery. In nursing a sick unit, giving a preferential position to purchase money security interest is of great significance. Purchase money credit in respect of inventory will be highly useful in helping the economic recovery of sick industrial units when they are given credit as part of a scheme of industrial reconstruction.

CONSEQUENCES OF ELIMINATION OF INSTALMENT SALE CONCEPT

2.2.2 While dealing with instalment credit for purchase money we saw, in Chapter 3, Part I, how at present the concurrent operation of the hire-purchase device adopted by the hire-purchase financing institutions and the hypothecation device employed by banks works inequitably to banks. We also saw how hire-purchase form of security device is a product of history and how it has lost its utility when hire-purchase became a tripartite arrangement and as a rule the manufacturers extend credit not directly but only through the agency of an intervening institution which may be a bank or a hire-purchase financing institution. We also noted how the concept of instalment sale has been practically dispensed with in the U.K. on the recommendations of the Crowther Committee and pursuant to the enactment of the Consumer Credit Act, 1974 and the repeal of the Hire-Purchase Act of 1965. In paragraph 1.3.79 we summed up the positive advantages which would accrue by elimination of the several drawbacks flowing now under the instalment sale concept. Hence, it is that the project study on personal property security law sponsored by the Committee has not subscribed to this concept in preparing its statutory scheme.

POINTS MADE OUT BY THE FEDERATION OF INDIAN HIRE-PURCHASE ASSOCIATIONS

2.2.3 When the draft Bill prepared by the project team was circulated to them, it is not surprising that the hire-purchase associations in our country have made a detailed study of the statutory scheme of the Bill and submitted their comments thereon through the Federation of Indian Hire-Purchase Associations (shortly, the "Federation"). Naturally, they are concerned with the consequences that may flow as a result of the hire-purchase transactions being understood having regard to their substance, namely, as secured transactions. The points made out by the Federation are considered herein. The Federation gave a memorandum and subsequently the members of the Legal Affairs Committee of the Federation had meetings with the Chairman and the Secretary of the Committee on several days when all the points involved were discussed with them in detail.

2.2.4 The points made out by the Federation could be classified under the following three major heads :

(1) Re. the necessity for continuance of the instalment sale concept particularly for motor vehicles;

(2) Re. certain hardships to hire-purchase finance companies envisaged under the new scheme; and

(3) Re. difficulties which may be experienced while extending instalment credit under the provisions of the new scheme.

Brief reference is made here to the points raised by the Federation and how they could be effectively and satisfactorily settled.

(1) RE. THE NECESSITY FOR THE CONTINUANCE OF THE INSTALMENT SALE CONCEPT PARTICULARLY FOR MOTOR VEHICLES

PARITY OF TREATMENT WELCOMED

2.2.5 The Federation welcomes the basis of the legislative scheme under which "hire-purchase financiers of motor vehicles and banks and financial institutions financing against hypothecation of motor vehicles should be treated on par under the new scheme, both eligible to get personal property security interest". The Federation agrees that this would facilitate the flow of necessary credit to road transport industry.

"INSTALMENT SALE" AND "INSTALMENT CREDIT" CANNOT CONCURRENTLY WORK EQUITABLY

2.2.6 But, the parity between instalment credit extended by hire-purchase financiers and instalment credit extended by banks and other

financial institutions cannot be maintained, were they to operate under two different schemes, one to be regarded as the "owner-lender" and the other as "secured party-creditor".

2.2.7 The necessity for covering under one scheme these two major groups which purvey instalment credit is clear when we find the difficulties experienced by banks in giving instalment credit concurrently with the prevalence of the concept of instalment sale. The facts and the decision in Manasuba's case[1] decided by Justice Ramaprasad Rao of the Madras High Court bring to the foreground the conflicts underlying the simultaneous application of the ratio of the decisions of the Supreme Court in Johar's case[2] and Sundaram Finance case.[3] We summed up in paragraph 1.3.79 of this report the other positive advantages of dealing under one statutory scheme instalment credit by banks and instalment credit by hire-purchase financing institutions.

WHAT ABOUT HIRE-PURCHASE ACT, 1972?

2.2.8 The Federation has referred to the enactment of the Hire-Purchase Act, 1972 based on an earlier report of the Law Commission chaired by Justice T. L. Venkatarama Aiyar. The Law Commission's report and the Act were further considered by two expert bodies — (i) the Study Group which reviewed legislation affecting banking, and (ii) the Banking Commission (1972).

2.2.9 The Study Group which reviewed legislation affecting banking observed that "the precedent of the Hire-Purchase Acts of 1938 and 1954 of the U.K., which was relied on by the Law Commission for its recommendation to exclude credit sale (as also conditional sale) contracts from the scope of the legislation proposed by that Commission, has not been followed in the U.K."[4] Commenting on the Hire-Purchase Act, 1972, the Study Group recommended that "the proposed legislation is essentially confined to strictly hire-purchase transactions and does not cover credit sale, or conditional sale, agreements. In view of what has been stated above and as the trend in other countries is to bring within a unified scheme the regulatory provisions applicable to both vendors' credit and lenders' credit, it is desirable that a fresh look is taken at the proposed legislation".[5] The Banking Commission went into the subject further and recommended that "on the law relating

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[1]1969 (I) Comp. L. J., p. 5.

[2]A.I.R. 1965 S. C. 1082.

[3]AI.R. 1966 S. C. 1178.

[4]Paragraph 8.25 of its report.

[5]Paragraph 8.27 *ibid.*

to instalment credits, the Hire-Purchase Bill, 1968, in our country, does not take note of the recent developments in the U.K., the U.S.A. and other countries. This measure requires further consideration".[1]

2.2.10 Evidently, the recommendations of the Study Group and of the Banking Commission are now under Government's consideration. Though the Hire-Purchase Act was enacted in the year the Banking Commission submitted its report, the legislation has not yet been brought into force. From the discussions with the representatives of the Federation and the officials of the Law Ministry, we understand that the Government are contemplating amendments to the Hire-Purchase Act before bringing it into force.

2.2.11 Under the above circumstances and in view of the fact that there is a great need for expediting reform in the field of credit-security law to facilitate the expeditious implementation of our economic programmes, this is the proper time to have a complete review of the scheme of our hire-purchase legislation. We concur with the recommendations of the earlier two expert bodies in this regard. In view of these factors, the fact that before the Banking Commission's recommendations could be considered the Hire-Purchase Bill, 1968 was passed by Parliament does not materially affect the position. On the contrary, the non-enforcement of the legislation so far is a positive factor which enables Government now to look at the whole spectrum of our credit-security law in its broad perspective and come forward with reformative legislative measures.

BANKING COMMISSION'S OBSERVATIONS ON HIRE-PURCHASE CREDIT

2.2.12 The Federation has drawn attention to the recommendations of two Study Groups which went into the different aspects of road transport finance, namely, (i) the Study Group on Road Transport Financing (1968) appointed by the Government of India, Ministry of Transport and Shipping, and (ii) the Study Group on the Provision of Credit Facilities (1969) appointed by the National Credit Council. As pointed out by the Federation, on the basis of these reports, the Banking Commission (1972) made the following observations in its report :

> "Hire-purchase form of credit is specially suited to borrowers like small transport operators, farmers and professionals needing equipment, who find it difficult to offer security to the lending institutions. In this form of credit, the goods themselves can serve as security because they remain the property of the lender until the loan is fully repaid."[2]

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[1]Paragraph 21.53 of its report.

[2]Paragraph 17.14 of its report.

> "There is a clear need to institutionalise hire-purchase credit and encourage the formation and growth of strong and viable units."[1]

In the face of the recommendations of the Banking Commission with reference to our Hire-Purchase Act, it is obvious that the Commission's reference to "hire-purchase form of credit", in the above context is only to the provision of instalment credit for purchase money.

2.2.13 The strengthening of the base of instalment credit is necessary for our economic development, especially for the development of smaller and weaker section of the society, like small businessmen, traders, merchants, truck operators, etc. In extending this credit, whether the security device takes the form of "hire-purchase" or "hypothecation", primarily the goods remain the security for the repayment of the debt. As the Banking Commission observed, the concept of the property in the lender is only to serve as security for repayment of the dues. It is necessary to preserve the security aspect. This is necessary with reference to provision of instalment credit by banks as well as by hire-purchase financing institutions. As earlier pointed out, this could not be equitably done by retaining archaic property concepts which were built into security devices due to historical accidents.

2.2.14 The institutionalisation of hire-purchase credit and encouragement for the formation and growth of strong and viable units could be effectively ensured only when the framework of our credit-security law allows ample scope both for banks and the hire-purchase financing institutions to play their proper role in dispensing purpose-oriented instalment credit for purchase money.

OBSERVATIONS OF THE RBI STUDY GROUP ON NON-BANKING COMPANIES

2.2.15 Then the Federation has also referred to the following observations of the Study Group appointed by the Reserve Bank of India under the chairmanship of Shri James S. Raj to go into the role of non-banking companies :

> "Three major points have to be taken into account in considering the question of prescribing ceilings on deposits accepted by hire purchase finance companies. First, there is a continuing need for encouraging the operations of well managed hire purchase finance companies because they satisfy the credit requirements of transport operators who belong to the priority sector of borrowers. According to the earlier studies as well as the one undertaken for the Group by the Economic Department of the Reserve

[1]Paragraph 17.16 of its report.

Bank into the working of hire-purchase and other finance companies in Delhi, many transport operators preferred hire-purchase finance companies to commercial banks on account of the informality of arrangements and the reluctance of commercial banks to extend finance on second-hand vehicles."[1]

The Study Group has further observed :

"Secondly, there is a wide variation in the operations of different hire-purchase companies working in the country. While the southern region is relatively well-served by hire-purchase finance companies, other regions, in particular the eastern region, are relatively neglected in this regard. In the north, although the number of hire-purchase finance companies has tended to increase, there are a number of weak units among them. The study referred to above shows clearly that many of the hire-purchase finance companies in Delhi failed because of the dishonesty of management as well as low stake of the owners in the concerns. This leads us to the third point, *viz.*, the reliance of hire-purchase finance companies on deposits and borrowings. Since their major business is to finance the purchase of vehicles, they have to borrow from the public as well as other financial institutions. Here also, there is a wide variation between different companies."[1]

These well-made out points of the Study Group refer to the diversity in the operational efficiency of hire-purchase companies and stress on their reliance on deposits and borrowings for providing instalment credit.

2.2.16 We earlier saw how dispensing with the concept of instalment sale in the field of instalment credit would enable banks to provide more freely direct finance to the priority sectors of borrowers, particularly, road transport industry. While encouragement is necessary for well-managed hire-purchase finance companies, the RBI Study Group has referred to the managerial inadequacies and low stake of the owners with reference to several other companies. Thus, in areas where well-managed and efficient hire-purchase finance companies are not functioning or where it is necessary to supplement the credit provided by or through such institutions, banks and other financing institutions may have to fill the gap. This would be facilitated by dispensing with the concept of instalment sale.

SECOND-HAND VEHICLES UNDER THE HIRE-PURCHASE ACT

2.2.17 As regards second-hand vehicles, the question of the hirer exercising an option not to purchase the vehicle is of much less significance and is of no meaning. It is in view of this that a specific

[1]Paragraph 5.23 of its report.

suggestion was made before the Joint Committee on Hire-Purchase Bill by the representatives of the South India Hire-Purchase Association "that 'owner' should include financier of used vehicles also. So clause 2(f) may also include financier of new and second-hand vehicles". [1] Again, with reference to second-hand vehicles the difficulty of finding out the cash price has been experienced and this is another factor coming in the way of the application of the hire-purchase scheme with reference to second-hand vehicles. These difficulties will not survive when instalment sale concept is not applied.

EXTENDING CREDIT TO ACQUIRE SECOND-HAND VEHICLES

2.2.18 It is necessary that instalment credit financing against second-hand vehicles should also be encouraged. Instalment credit for purchase money where the goods acquired by the debtor are second-hand vehicles could be effectively provided both by banks and by hire-purchase financing institutions. Where well-managed hire-purchase financing institutions are functioning and because of their operational efficiency borrowers are having recourse to them, they need not be and will not be adversely affected under a scheme which provides for a parity between banks and hire-purchase financing institutions extending instalment credit for purchase money.

IS NOTING HYPOTHECATION IN REGISTRATION CERTIFICATE ADEQUATE ?

2.2.19 It is true that under the provisions of the Motor Vehicles Act, 1939, as they stand now, in the certificate of registration of a motor vehicle a hire-purchase financier or a hypothecatee-bank can have his interest noted. This by itself is not adequate to protect the security interest of a bank *vis-a-vis* the claims of a hire-purchase financier. A hire-purchase financier may fail to make such noting; even then (under the instalment sale concept) he gains preference over a bank which has noted its claim in the certificate of registration. With reference to a company-borrower, the same position prevails as regards the claims of a hire-purchase financier *vis-a-vis* a bank-lender, the former not having registered his claim under section 125 of the Companies Act, 1956, while the latter having done it. These were the facts in the Manasuba's case.

MOLONY COMMITTEE'S VIEWS

2.2.20 The Federation has also referred to the observations of the Committee on Consumer Protection (1959) set up in the U. K. under the chairmanship of Mr. J. T. Molony. Though that Committee felt that in spite of its deficiencies, the fundamental structure of hire-purchase need not be radically altered, the subsequent developments in the U. K., as earlier referred to, have necessitated the legislation

[1] RAJYA SABHA—Joint Committee on Hire-Purchase Bill, 1968, p. 61.

in the U. K. in the form of the Consumer Credit Act, 1974, which has substantially fused together the applicable provisions of instalment credit in the form of lenders' credit and in the form of vendors' credit.

CONSUMER PROTECTION—ITS NEXUS WITH HIRE-PURCHASE FORM

2.2.21 Lastly, we may refer to the necessity for consumer protective provisions as regards weaker sections of the borrowers. There is no doubt that consumer protection is necessary. Its need is all the greater as regards lending by the hire-purchase financiers so long as they have in law the right of "snatch-back". Established hire-purchase companies do not as a rule have recourse to this right. The Hire-Purchase Act also seeks to curb the exercise of this right. When a hire-purchase transaction is viewed as a form of secured credit transaction, the right of "snatch-back" is obviously eliminated with no undesirable consequence either to the class of borrowers or to the hire-purchase lenders. This is as it should be.

SPECIAL SAFEGUARDS NECESSARY FOR CONSUMER CREDIT

2.2.22 It may be that from the point of view of consumer credit certain special safeguards may have to be provided for. But the security aspect has nothing to do with the provision of such safeguards. Once we bring under one scheme of personal property security law all forms of security devices including provision of instalment credit for purchase money in the form of hire-purchase, then on a review of the hire-purchase legislation the necessity for amplifying or amending suitably any provision for protecting the interests of consumers in addition to those which may be available under the general scheme may have necessarily to be gone into. But this will not affect the security aspect of instalment credit transactions for purchase money, particularly instalment credit for business and commercial requirements.

(2) RE. CERTAIN HARDSHIPS TO HIRE-PURCHASE FINANCE COMPANIES ENVISAGED UNDER THE NEW SCHEME

2.2.23 The Federation has referred to the following hardships which in its view may be encountered by hire-purchase financing institutions under the new scheme :—

(a) the application to them of the money-lending legislation; and

(b) their position *vis-a-vis* the Reserve Bank of India Directives regarding acceptance of deposits.

(a) APPLICATION TO THEM OF THE MONEY-LENDING LEGISLATION

Constitutional position

2.2.24 The new scheme will not affect legislation relating to money-lenders and money-lending. The new scheme provides a code for the creation and the regulation of a security interest in personal property by way of a special contract, that is, under a security agreement concerning personal property. While the law relating to special contracts comes under the Concurrent List, money-lending is exclusively a State subject. Thus, in pith and substance, the legislative scheme of personal property security law will come under the Concurrent List. Neither money lending legislation nor the personal property security law will mutually affect each other.

ARE HIRE-PURCHASE COMPANIES MONEY-LENDERS?

2.2.25 But, there is no ground for any apprehension that, on the enactment of a legislation bringing into force the new scheme relating to personal property security law, hire-purchase companies would be regarded only as a class of money-lenders. Their classification does not rest purely on their lending function which they share along with other banking institutions.

2.2.26 The Banking Commission's Study Group which reviewed legislation affecting banking, the Banking Commission (1972) and the Study Group on Non-Banking Companies set up under the chairmanship of Shri James S. Raj have all recognised the role of hire-purchase companies, which mainly rely on acceptance of deposits from the public, as a class of institutions engaged in *para-banking activities.*

'BANKING' DEFINITION AS APPLIED TO HIRE-PURCHASE FINANCE COMPANIES

2.2.27 "Banking", as the Banking Regulation Act, 1949 would define, is acceptance of deposits from the public for the purpose of lending or investment. Hire-purchase companies, which accept deposits from the public along with other financial institutions which rely on acceptance of deposits from the public, are engaged in a form of banking. Though the definitions of "banking" and "banking company" in the Banking Regulation Act would encompass also companies which are authorised to accept *only* non-chequeable deposits from the public for lending or investment, administrative understanding of the difficulties of applying a rigorous scheme of banking regulation to such institutions, as envisaged in the Banking Regulation Act, 1949, has led to the Parliament enacting a milder form of legislation appropriate to the circumstances of the case.

2.2.28 The above position is clearly pointed out in the report of the Study Group which reviewed legislation affecting banking and in the report of the Banking Commission.

2.2.29 Suffice it now to give the following assessment of the status of "non-banking financial companies" *vis-a-vis* "non-banking non-financial companies" made by the Study Group on Non-Banking Companies chaired by Shri James S. Raj:

> "In making its recommendations on regulating the acceptance of deposits by NBCs,[1] the Group has made a distinction between non-banking and non-financial companies and NBFCs.[2] The reason, as explained earlier, is that the latter are para banks whose activities consist of accepting deposits for the purpose of making loans and advances, unlike the manufacturing and trading companies which normally accept deposits for use in their own business. Since *NBFCs belong to the genre of commercial banks*, their activities have to be regulated broadly on the same lines as those of commercial banks."[3] (emphasis added.)

Hire-purchase companies now regulated as para banks

2.2.30 As the Study Group on Non-Banking Companies has clearly pointed out, hire-purchase companies classified as non-banking financial companies are strictly banking institutions as defined in the Banking Regulation Act, 1949, though a milder form of banking regulation is applied to them now pursuant to the Directives issued by the Reserve Bank of India under Chapter III-B of the Reserve Bank of India Act, 1934. As the Study Group has observed, since they belong to "the genre of commercial banks, their activities have to be regulated broadly on the same lines as those of commercial banks". Underlying this exposition is implicit that the application of money-lending legislation to them is entirely inappropriate.

Money-lending legislation always excludes banking institutions

2.2.31 Money-lending legislation is more ancient than banking regulation. In the U. K., the money-lending legislation was first enacted and banks were kept outside the scheme of this legislation. In the Kirkwood's case,[4] difficulty was experienced in classifying a financing institution which was also accepting deposits from the public. This difficulty was due to the absence of a statutory definition of "banking" in the U. K. Subsequently, the U. K. Companies

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[1]Non-banking companies.

[2]Non-banking financial companies.

[3]Paragraph 2.22 of its report.

[4]1966 (1) All England Report, 968.

Act was amended empowering the Board of Trade to certify in doubtful cases as to whether or not an institution is carrying on the business of banking. But right through, the position in the U. K. has been that banking institutions have not been subjected to the money-lending legislation.

2.2.32 In our country also, moneylending legislation was first developed before there was legislation for banking regulation. When our money-lending legislation was made following the U. K. model, specific exemption was provided for banks. The subsequent legislation on the subject of money-lending has continued this exemption. Appendix X to the Report of the Expert Group appointed by the Reserve Bank to consider State Enactments having a bearing on commercial banks' lending to Agriculture gives a State-wise analysis of the position which shows that money-lending legislation of practically all the States exempt banks *inter alia* from the ceiling as to rates of interest that could be charged on secured loans. In view of the definition of "banking" found in our Banking Regulation Act, 1949, it is obvious that hire-purchase finance companies, which accept deposits from the public for lending (under instalment credit or instalment sale basis) and thus are a class of banking institutions, have continued to stay away from the operation of the money-lending legislation and this position will continue. However, it is appropriate that the form of regulation now applied to this class of banking institutions is brought as part of a comprehensive scheme of banking regulation. Such a form of regulation has already been recommended by the Banking Commission (1972). Government may like to consider making in due course appropriate changes to the Banking Regulation Act, 1949, so that a class of banking institutions which are now regulated as non-banking institutions may be regulated hereafter having regard to their true status, namely, as a class of banking institutions.

Same position under the Constitution

2.2.33 Apart from the specific exemption in the money-lending legislation of different States in favour of banks, such legislation cannot also extend under the Constitution to banks and banking institutions, since "banking" is exclusively a Union subject.

(b) Position of Hire-Purchase Finance Companies *vis-a-vis* RBI Directives regarding Acceptance of Deposits

Anomaly re. deposit-taking by firms and sole proprietary concerns

2.2.34 We may refer here also to the comment of the Study Group on legislation affecting banking with reference to private bankers, that is, firms and proprietary concerns which accept deposits from

the public for the purpose of lending or investment. That Study Group has pointed out that it is anomalous that while persons who carry on lending function with their own resources (money-lenders) are subjected to a form of regulation, those who do lending with deposits from the public *but who have not incorporated themselves* are not subjected to any form of regulation.

2.2.35 Thus, there may be a case for the Centre to review the extent of regulation as regards acceptance of deposits from the public by firms and proprietary concerns. If, in public interest and to subserve the common good, the law relating to acceptance of deposits from the public prohibits firms and proprietary concerns from having recourse to deposit-taking function, it would only be a necessary incident of the Union's right to regulate the business of banking in accordance with such objectives.[1]

Deposit-taking by corporate bodies is now under banking regulation

2.2.36 As regards corporate bodies or companies which are now under the umbrage of the Reserve Bank's regulation flowing either under the Reserve Bank of India Act, 1934, or under the Banking Regulation Act, 1949, there is no necessity for the application of the moneylending legislation. Nor is there any scope for any such application in view of the statutory definition of "banking" in the Banking Regulation Act, 1949, and the Constitutional position.

2.2.37 Since instalment credit by hire-purchase finance companies to the transport industry is considered necessary to be encouraged, we are also recommending that, where a financial institution which accepts deposits from the public and which is notified by the Central Government in this behalf, provides instalment credit, whether in the form of hire-purchase agreement or otherwise, in relation to motor vehicles, it should also be eligible to the priorities and privileges available to banks in general under the scheme of the personal property security law.

RBI Directives re. hire-purchase companies really based on their functional role

2.2.38 The Reserve Bank's Directives, as applicable to hire-purchase finance companies, do not lay down any ceilings on the quantum of deposits which such companies may accept. The Study Group on Non-Banking Companies chaired by Shri James S. Raj has, in

[1]Please see also the observations of the Supreme Court in R. C. Cooper v. Union of India (A.I.R. 1970 S. C. 564 at 600) where the majority of the Court held that the Union may, as a necessary incident of certain rights assumed by it, prohibit by law the named banks from carrying on banking business.

paragraph 5.22 of its report, noted the special position of such companies under the Directives. *This special and preferential position of hire-purchase finance companies under the Reserve Bank's Directives is not based on the colour or the form of the security device adopted by such companies but on the fact that they provide essential instalment credit to the road transport industry.*

2.2.39 The James Raj Study Group has recommended continuance of the special status of the hire-purchase finance companies in order to encourage the operations of well-managed hire-purchase finance companies, as they satisfy the credit requirements of transport operators who are in the priority sector of borrowers. So long as this role is effectively played by hire-purchase finance companies, they will be fully satisfying the main basis on which they are allowed to accept deposits to the extent permitted now under the present Directives.

2.2.40 In section 45I of the Reserve Bank of India Act, 1934, the relevant portion of the definition of "financial institutions" has been altered in 1974 to refer to institutions entering into hire-purchase agreements as defined in the Hire-Purchase Act, 1972. This is a restrictive view of hire-purchase agreements; this covers only those agreements with option clause. How this link with the option clause perpetuates the instalment sale concept and brings in anachronistic and undesirable results have been summed up by us in paragraph 1.3.79. By dispensing with the archaic and anachronistic notion of instalment sale, we are only making clear the functional role of the hire-purchase finance companies. In order to avoid a legally restrictive view and to make the position abundantly clear, we are recommending an amendment to section 45I of the Reserve Bank of India Act, 1934, so that the section would cover *inter alia* all "non-banking institutions" providing instalment credit for purposes that may be approved by the Reserve Bank.

Applicability of sales tax legislation

2.2.41 The Federation has raised a point that when we dispense with the concept of instalment sale, the States may lose revenue as some notional sales will cease to be considered as sales. Subsequent to the decision in Johar's case, the Supreme Court has, in its decision in Sundaram Finance case, reviewed the position again as regards hire-purchase transactions. There the Court has held that even though a hire-purchase form is adopted, a transaction may be only a secured arrangement not amounting to a sale. Even in a transaction where the option clause is present, particularly with reference to motor vehicles, no sales tax is now involved as State legislation as regards

sales tax on motor vehicles provides only for a single point levy. Where in substance an agreement is only a secured transaction, there is also no legality or justification for considering it as a sale.

(3) RE. DIFFICULTIES WHICH MAY BE EXPERIENCED IN EXTENDING INSTALMENT CREDIT UNDER THE PROVISIONS OF THE NEW SCHEME

2.2.42 With reference to some specific provisions of the draft Bill prepared by the project team, the Federation has made some points. It has referred to some difficulties that are likely to be experienced in extending instalment credit under the new scheme, particularly with reference to the road transport industry. These points relate to—

(i) creation of successive security interests in motor vehicles;

(ii) conflicts re. security interests in chassis of a motor vehicle and in the body built thereon;

(iii) reconciliation of claims for priority arising as a result of (ii);

(iv) scramble for taking possession that may result on default in respect of a vehicle financed by two or more creditors having successive security interests in the motor vehicle;

(v) scope for the application of the rule as to commingled goods regarding a motor vehicle;

(vi) need for a provision similar to rule 113(4) of the Kerala State Motor Vehicles Rules, 1961; and

(vii) consideration relevant to the limit that a hire-purchase company may grant while extending credit for acquiring a motor vehicle.

The above points are considered below.

2.2.43 The points raised by the Federation have particular reference to the specific characteristics of instalment credit for purchase money against motor vehicles. It is necessary that the scheme of our personal property security law should give special recognition to such characteristics. It is not necessary for that purpose to perpetuate the archaic and anachronistic property concepts in our credit-security law. Such recognition could be inbuilt in the scheme.

2.2.44 Except items (v) and (vi), the points raised by the Federation are attributable to the features which ordinarily are not valid in a general scheme of personal property security law but which have to be recognised in the context of instalment credit for purchase money

against motor vehicles. Appropriate recognition in our personal property security law regarding instalment credit for purchase money for motor vehicles is required on the following aspects:

(i) purchase money credit against a chassis of a motor vehicle is required in the first instance and additional finance is required for constructing a body thereon — the commercial situation is such that it would be inadvisable and may not be practicable, were two financiers to intervene separately (unless they act as a consortium), one providing credit for the acquisition of the chassis and another giving credit for the construction of the body; and

(ii) the fact that commercial and administrative convenience does not encourage registration at the same time of two or more successive security interests in the same vehicle.

As the Federation has rightly pointed out, instalment credit for purchase money against motor vehicles is necessary for strengthening our road transport industry and for helping small borrowers in getting the necessary financial assistance. In an era of credit planning, when hire-purchase finance companies and banks are extending credit having regard to the productive requirements of the industry, the company or the bank which extends credit for the acquisition of the chassis of a motor vehicle may also legitimately be expected to take into account and accommodate suitably the financial requirements of the borrower for constructing a body on the chassis. It is also a sound principle that a borrower avails himself of credit both for the chassis and for the body from the same instalment credit financing institution.

TEMPORARY PERFECTION AGAINST MOTOR VEHICLES

2.2.45 There is an interregnum from the time of the acquisition of the chassis of a motor vehicle and the construction of a body thereon. Registration is normally possible only after the body is built. Though section 25 of the Motor Vehicles Act, 1939 does permit temporary registration of a motor vehicle when the vehicle is in the form of only a chassis, it is neither commercially expedient nor administratively convenient to insist on every chassis first to be temporarily registered and then to have a regular registration after a body is built thereon. This position arises having regard to the number of vehicles and the workload that may have to be handled by the Regional Transport Authorities. It is not also easily possible to reconcile the claims of conflicting security interest holders in a motor vehicle in such a case.

2.2.46 By giving to instalment credit financiers who lend against the chassis of a motor vehicle a perfected security interest and enabling them to rely also on the body built thereon for securing their purchase money credit for the acquisition of the motor vehicle, we would be avoiding the difficulties that would otherwise be experienced, attention to which has been drawn by the Federation.

2.2.47 Hence, we have to specially provide in the scheme of personal property security law that a security interest for purchase money which has attached to the chassis of a motor vehicle before the body is built thereon shall be deemed to be perfected for a period of three months from the date of such attachment, and that during this period the body built thereon shall be an addition to the security notwithstanding the general rules relating to accessions. In exceptional cases where this three month period may not be adequate, recourse may be had to temporary registration of the vehicle as a chassis and noting of the security interest in the temporary certificate of registration.

ELIMINATION OF REGISTRATION *RE.* SUCCESSIVE SECURITY INTERESTS IN MOTOR VEHICLES

2.2.48 It is in view of the difficulties that would be experienced in case successive security interests are to be noted in the certificate of registration of a motor vehicle, section 31A of the Motor Vehicles Act, 1939, as it stands now, does not permit a cancellation of an entry of a security interest thereon (hire-purchase interest or hypothecation interest, as the case may be) without the consent of the person whose name appears in the certificate of registration as the security interest holder. The draft Bill of the project study has also recognised this position and has provided that "no entry regarding transfer of ownership of any motor vehicle which is subject to a security interest shall be made in the Register of Motor Vehicles or a certificate of registration except with the written consent of the person whose name appears in the Register of Motor Vehicles and the certificate of registration as a person entitled to a security interest in the motor vehicle".

2.2.49 But if two or more successive security interest claims are to be noted, it will be throwing an unduly heavy burden on the borrower as he will have to obtain the consent of all such security interest holders before he could effectively transfer the vehicle. As the Federation has pointed out, it is likely that the borrower may require finance for meeting the running cost of the vehicle, like replacing the tyres, petrol charges, *etc.* But commercial expediency does not permit giving of any perfected status to such claims; as otherwise, instalment credit financing of motor vehicles would run into unnecessary

difficulties. Hence, in line with the principle underlying the present section 31A of the Motor Vehicles Act, 1939, it may have to be provided that at any point of time there could be only one registration of a security interest against a motor vehicle.

OTHER DIFFICULTIES DO NOT SURVIVE

2.2.50 When the above points are taken care of, the expected conflict between a person claiming a security interest in the chassis of a motor vehicle and a person claiming a security interest in the body built thereon will not arise. Hence, the problem of reconciling claims as regards their priority will also not arise. At any point of time there will be only one perfected security interest in a motor vehicle and this will rank superior to the interest of any person claiming an unperfected security interest in the vehicle. Again, since only perfected security interest holders and banks are allowed to exercise the right of directly taking possession of the vehicle in the event of default, the possible scramble, for taking possession of the vehicle on default, by more than one person claiming a perfected security interest in the vehicle, is also avoided.

2.2.51 Since the chassis financier can naturally look to the body built on the chassis as accession to his security, he can as usual take into account the value of the body that may be built thereon, as additional security, and decide on the limits of finance.

RULE AS TO COMMINGLED GOODS

2.2.50 When the above points are taken care of, the expected conflict provides a rule of convenience when goods subject to security interests are mingled in the course of manufacturing, processing, assembling or commingling in such a way *that their identity is lost in the product or mass.* The test here is that before the goods can be considered as commingled their identity has to be lost in the product or mass. The apprehension of the Federation that this rule may be applied to motor vehicles is not obviously correct.

PROVISION SIMILAR TO RULE 113(4) OF THE KERALA STATE MOTOR VEHICLES RULES, 1961

2.2.53 Rule 113(4) of the Kerala State Motor Vehicles Rules, 1961, provides as under:

> *"Issue of fresh registration certificate for default of owner*
>
> If the party, other than the owner to an agreement of hire-purchase satisfies the Registering Authority that he has taken possession of the vehicle owing to the default of the owner under

the provisions of the agreement and that the owner has absconded or refused to deliver the certificate of registration, the Registering Authority may after giving the owner an opportunity of being heard and notwithstanding that the certificate of registration is not produced before it, cancel the certificate of registration and issue a fresh certificate of registration in the name of the party to the agreement of hire-purchase, after realising the fee prescribed for endorsing transfer of ownership prescribed in sub-rule (3) of rule 129 and deliver it to the other party. If notice is sent to the owner by registered letter to the address stated in the certificate of registration (giving him reasonable time for his appearance) the owner shall be deemed to have been given an opportunity of being heard within the meaning of this sub-rule."

2.2.54 The provision in the Kerala State Motor Vehicles Rules is to be contrasted with a similar provision found in sub-section (5) of section 31A of the Motor Vehicles Act, 1939. Under section 31A(5), when a hire-purchase financier (including a hypothecatee) of a motor vehicle satisfies the registering authority that he has taken possession of the vehicle owing to the default of the registered owner under the provisions of the security agreement and that the registered owner refuses to deliver the certificate of registration or has absconded, the registering authority is authorised to cancel the certificate of registration and issue a *duplicate thereof.*

2.2.55 However, Rule 113(4) of the Kerala State Motor Vehicles Rules, 1961, framed by the Kerala State Government pursuant to their Notification No. 238/70 dated 29th April 1970 cannot supersede the provisions of sub-section (5) of section 31A of the Motor Vehicles Act, 1939, which is a Central enactment on a subject coming under the Concurrent List in the Seventh Schedule to the Constitution (Entry No. 35). Hence, after the introduction of section 31A of the Motor Vehicles Act, 1939, by section 13 of the Motor Vehicles (Amendment) Act (56 of 1969) which came into force on 1st October 1970, Rule 113 (4) of the Kerala State Motor Vehicles Rules may have to yield place to sub-section (5) of section 31A of the Act.

2.2.56 The provision in the Central Act providing for the issue of a duplicate is not helpful. Since the duplicate will have to be issued in the name of the hirer-borrower, the secured party (hire-purchase lender or hypothecatee) will be considerably handicapped in realising his dues by disposing of the vehicle. This defect is cured by the provision in the Kerala State Motor Vehicles Rules which provides for the certificate of registration being issued "in the name of the party to the agreement of hire-purchase".

2.2.57 Having regard to the Constitutional position and the merits of the case, it is necessary to amend sub-section (5) of section 31A in such a way as to enable the registering authority to issue a fresh certificate of registration (*not a duplicate thereof*) in favour of the secured party who has noted his security interest in the certificate of registration.

2.2.58 Certificate of registration is a document of title. There is already commercial recognition of the fact that the certificate of registration is the document of title for the motor vehicle. There is also an implied legal recognition of this fact, as the law now provides for noting in the certificate of registration the security interest in the vehicle in favour of the hire-purchase lender or the hypothecatee. However, there is no adequate legal base now for expressly treating the certificate of registration as a document of title.

2.2.59 Hence, it is necessary to have a statutory provision to protect secured parties entering into a security agreement regarding a motor vehicle in good faith and for value with a person in whose name the certificate of registration of the motor vehicle stands. It is also necessary to provide that when such a secured party has his security interest recorded in the certificate of registration, no other person claiming an interest in the vehicle shall be entitled to assert his claim in preference to the claim of such secured party. Section 31A of the Motor Vehicles Act, 1939, also requires suitable amendments to provide for registration of security interests consistent with the provisions of the personal property security scheme we are recommending.

GRACE PERIOD FOR PERFECTING PURCHASE MONEY SECURITY INTEREST

2.2.60 We have earlier seen why temporary perfection has to be conferred on a purchase money secured party in respect of a motor vehicle when he has initially financed only the chassis and the body thereon is yet to be built. The period of temporary perfection in such circumstances may be necessary for a duration of three months from the date of attachment of the purchase money security interest on the chassis of the vehicle.

2.2.61 With reference to a purchase money security interest in respect of personal property other than a motor vehicle, there is necessity for a grace period during which the interest of a secured party extending such credit may have to be protected irrespective of registration or possession. This is consistent with the commercial necessity whereby a minimum period of time may be necessary for the borrower to obtain the goods after availing himself of finance for purchase money.

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A grace period of ten days has been recognised in the statutory schemes of other countries, which recognise the functional and superior role of purchase money credit.

2.2.62 Hence, it is necessary to provide that a security interest for purchase money in goods (other than a motor vehicle) remains automatically perfected for a period of ten days from the date the debtor obtains possession of the property. Such a security interest shall have priority over the interest of any transferee from the debtor claiming under a transfer not in the ordinary course of business of the debtor but effected during this period. It is also necessary to provide on similar lines with reference to any conflicting security interests in the secured property or its proceeds, other than inventory.

PURCHASE MONEY SECURITY INTEREST IN INVENTORY

2.2.63 Recognition of a preferential position for purchase money security interest in inventory helps considerably the industrial reconstruction of sick units. Such recognition of a preferential position is found in the other statutory schemes. Hence, under our scheme it is necessary to give preference to purchase money security interest in inventory.

2.2.64 But a security interest for purchase money in inventory can be given a priority only subject to safeguards which on the one hand will ensure the *bona fides* of the arrangement and on the other will give reasonable protection to earlier registered security interests in inventory.

2.2.65 In order to claim priority over a conflicting security interest in the same inventory, or in identifiable cash proceeds received from such inventory, the purchase money security interest in inventory should satisfy the following conditions:

(1) the security interest for purchase money should be perfected at the time the debtor receives possession of the inventory; and

(2) the person having security interest for purchase money should give notice in writing to the person having the conflicting security interest where the latter had registered his security interest covering the same types of inventory —

  (i) before the date of the registration by the person having security interest for purchase money; and

  (ii) before the beginning of the thirty day period where under trust receipt type of advances the security interest for purchase money is temporarily perfected in favour of a bank; and

(iii) the holder of the conflicting security interest should receive the notice before the debtor receives possession of the inventory; and

(iv) the notice should state that the person giving the notice has acquired or expects to acquire a security interest for purchase money in the inventory of the debtor, describing such inventory by item or type.

CURRENT CROP LOANS BY BANKS

2.2.66 The purchase money priority has to be recognised whether the credit is for a commercial purpose or is extended for an agricultural purpose. Having regard to the predominantly rural bias of our economy and the need to promote measures that would facilitate agricultural production, it is necessary that in our statutory scheme we should provide a prioriy for current crop loans by banks.

2.2.67 Where a bank gives consideration to enable the agriculturist-borrower to produce current crops, there should be a preference in favour of such credit and the credit should have a first charge on the current crops. The credit may have to be extended before the crops come into existence by planting or otherwise. Thus, the perfected status for a bank's advance for current crop may have to be provided for so long as other conditions to ensure that the advance is for production of current crops are satisfied.

2.2.68 Ordinarily, when a bank gives consideration to enable the debtor to produce the crops and that is given not more than three months before the crops become growing crops by planting or otherwise, the bank should have priority over any earlier perfected security interest, even though while giving the consideration the bank knew of the earlier security interest. The Central Government should be authorised to vary by rules the period of three months for the different areas of our country having regard to the nature of the crops, the seasonal and other local conditions.

2.2.69 We are discussing later the machinery for registration and suggesting simplified provisions for effecting registration of security interests in personal property. Here we may mention that in order that others may be put on notice of the credit given by a bank for producing current crops, the crop loan will have to be required to be registered in Book 1 maintained by the Sub-Registrar of Assurances with suitable description of the land.

CHAPTER 3

CREDIT AGAINST FIXTURES AND ACCESSIONS

We traced earlier (in Chapter 2 of Part I) the nature of problems relating to fixture financing. We noticed how the subjective assessment of the courts as to the nature of the fixture brings in an uncertainty in this type of financing. We also noted how in dealing with fixture financing we may have to balance the claims of a long-term financing institution which may have given project finance for establishing an industrial unit and the claims of a commercial bank which may be financing the acquisition of a machinery by such unit for installation in the factory.

FIXTURE — A MOVABLE PROPERTY

2.3.2 That the present rules are unsatisfactory is clearly recognised. In the U.K. also, the Crowther Committee has highlighted this problem. Banks and term lending institutions in our country are also aware of the difficulties that are now being faced. In balancing the conflicting claims arising in fixture financing we have also to take into consideration the cost element. Identifying a security interest in a fixture with the land charge unduly adds to the cost of the credit. This is neither necessary nor desirable.

2.3.3 Fixture financing has to be distinguished from the financing of construction of buildings and other permanent structures on the land. It is only machinery and such other heavy implements which are detachable from land or building that could be classified as fixtures. If a machinery is detachable from the land or building without material damage to the permanent structure, then it should be treated as a movable asset and its financing should be properly covered in a personal property security law. On this basis, the statutory scheme suggested by us is treating fixture as a movable asset and for the purposes of registration of a security interest in a fixture, appropriate special provisions have been recommended.

FIXTURE — DEFINITION

2.3.4 In the light of the special characteristics of fixture-financing and the treatment accorded to fixtures in other comparable models on credit-security law, a fixture should be defined as goods embedded in the earth or affixed to what are so embedded and shall include—

(a) goods that are severable from a building or land by unscrewing, unbelting, unclamping or uncoupling or by some other method of disconnection, and

(b) machinery installed in a building which is capable of being removed without substantial damage to the building apart from the removal or destruction of the bed or casing on or in which the machinery is set and the making or enlargement of an opening in the walls of the building sufficient for the removal of the machinery.

But the definition shall not include building and building materials.

2.3.5 In order to avoid ambiguity in the description of a fixture, the expressions "building" and "building materials" also require to be defined on the lines recommended in the draft Bill proposed by us.

FIXTURE—PERFECTION

2.3.6 The perfection of a security interest in a fixture has to be by a method which would give notice to the persons dealing with the factory or the land of the existence of a fixture charge in favour of the fixture financier. While the basic concept of fixture as a movable asset has to be retained, the machinery now available for registration of land charges should be effectively used under a simplified procedure for recording security interests in fixtures.

2.3.7 In the Schedule (The Fifth Schedule) to the draft Bill we are recommending, we have recommended a separate Part in the Registration Act, 1908 and therein have suggested special provisions for recording security interests in fixtures. A security interest in a fixture shall be recorded in Book 1 referred to in Item A of sub-section (1) of section 51 of the Registration Act, 1908. An application for registration of a security interest in a fixture shall be made in the manner provided for by the rules. The rules may provide for the manner in which such an application shall be executed, verified and authenticated. The application shall contain a description of the immovable property to or in which the fixture is or is to be affixed or embedded. Under the

simplified procedure we are recommending, an application for registration of a security interest in a fixture, as with reference to other forms of personal property, may be effected by post.

FIXTURE—PRIORITY RULES

2.3.8 In line with the principles we discussed earlier for reconciling conflicting security interests in a fixture, we recommend the following rules which are based on the rules now in force in other comparable models:

(1) A security interest that attaches to goods before they become a fixture shall subsist and shall have priority as to the goods over the claims of any person who has an interest in the immovable property, provided the application for registration of such security interest as applicable to a fixture is made within a period of thirty days from the date the goods become a fixture.

(2) The security interest in a fixture arising after the goods became a fixture shall be subordinate to the interest of a creditor with a prior registered encumbrance on the immovable property in respect of any subsequent advance made in accordance with section 79 of the Transfer of Property Act, 1882.

(3) A perfected security interest in a fixture arising after the goods became a fixture shall have priority over the claims of any person who subsequently acquires an interest in the immovable property but not over any person who had a registered interest in the immovable property at the time the security interest attached to the fixture.

FIXTURE—SPECIAL RULES ON DEFAULT

2.3.9 A fixture-charge holder when he has priority over the claims of a person having an interest in the immovable property shall have power to remove the fixture from the immovable property in the event of default by his borrower. However, the fixture-charge holder shall be liable to reimburse any encumbrancer or owner of the immovable property other than the borrower, for the cost of repairing any structural damage that may be caused by the removal of the fixture. A person entitled to such reimbursement may require the fixture-charge holder to furnish adequate security for such reimbursement.

2.3.10 A fixture-charge holder, before effecting the removal of the fixture from the immovable property, should also be required to give a suitable notice to each person in whose favour there exists a registered interest in the immovable property. After giving such notice, he

should allow a period of twentyone days for any such notified person to pay the amount due in respect of the fixture charge. The court, in appropriate cases, may extend the time for such payment.

ACCESSIONS

2.3.11 Just as a fixture is embedded in or affixed to the land or building, an "accession" is a property that may be affixed to another *movable* asset. Thus, a fixture is attached to an immoveable and accession is attached to a moveable. It is true that the giving of finance for accessions has not developed in our country. But, as the Crowther Committee has pointed out in the U.K., it would considerably facilitate matters if the law could give the necessary framework for such credit. Generally, finance for an accession would be for purchase money.

2.3.12 "Accession" may be defined as goods that are installed in or affixed to other goods. The priority rules that may be applicable to accessions will be analogous to the rules that are formulated to reconcile the claims of a person having an interest in the land and those of the person having an interest in the fixture. A person having a security interest in the principal goods to which the accession is made would enjoy a status comparable to the position of the person having a security interest in the land or building. The person claiming a security interest in the accession would claim a position akin to that of the fixture-charge holder. However, the special rules of registration applicable to a security interest in a fixture will have no application to the registration of a security interest in an accession. A security interest in an accession could be perfected under the methods available with reference to other goods.

2.3.13 In the event of default, the person having a security interest in the principal goods shall have the right to redeem the security interest in the accession. He should also be entitled to be reimbursed for any damage to the principal goods that may arise consequent on the removal of the accession from the principal goods.

CHAPTER 4

CREDIT AGAINST ACTIONABLE CLAIMS AND OTHER GENERAL INTANGIBLES

It has to be recognised that accounts receivables (or book debts) are more liquid than goods held as inventory. In our country though accounts receivables are no doubt taken into account by banks and financing institutions in assessing the repaying capacity of borrowers, not much commercial value is given to accounts receivables as effective security. Hence, advances exclusively against book debts are not widely prevalent in our country and banks generally accept book debts only as additional security or as part of a composite security. *Notwithstanding the recognition that accounts receivables are more liquid than goods held as inventory, advances against accounts receivables are generally restricted only to first class parties of undoubted integrity and creditworthiness.*

2.4.2 Opinions are also now divided as to whether advances against book debts are to be treated as secured or unsecured. While some banks classify them as secured, others treat them as unsecured. While it is true that advances against accounts receivables (or book debts) are not substitutes for advances by way of discount of bills which are amenable to better control, it has to be recognised that it is only a small portion of commercial liabilities that are eligible for bank advances which are covered by the Bill Market Scheme. Hence, it is essential that the legal framework governing advances against accounts receivables is sufficiently strengthened to facilitate that such advances are made available not merely to a few borrowers but are made available to all eligible commercial concerns and that there is no doubt as regards such advances being secured or unsecured.

METHODS FOR EXTENDING CREDIT AGAINST ACCOUNTS RECEIVABLES

2.4.3 There are now two methods adopted by banks in India and elsewhere for granting of advances against accounts receivables. Book debts, existing or future, may be either assigned or hypothecated to a lending bank. The security agreement sometimes contains a clause authorising the lending bank to act as an attorney of the borrower

and collect the book debts on his behalf, and under certain circumstances appoint a receiver for collection. The practice generally follows the pattern in other countries as regards such advances. However, while in other countries there are adequate statutory provisions to safeguard advances against accounts receivables. the position in our country is entirely unsatisfactory.

EFFECT OF ASSIGNMENT

2.4.4 The position in our country follows the common law rule under which choses in action are not legally assignable but an equitable assignment thereof has come to be recognised. Since the effect of an assignment of an account receivable is recognised only as an equitable assignment, the assignment is always subject to the equities in favour of the obligor. Again, it is enforceable only as a personal claim and enforceable against third parties only when they have notice thereof. The provisions of our Transfer of Property Act dealing with actionable claims substantially reflect this position. There is also considerable doubt as to the assignability of benefits under executory contracts. *These factors have by and large contributed to the lack of development of factoring business in our country.*

CONTRACT RIGHTS TO BE MADE NEGOTIABLE BY AGREEMENT

2.4.5 In order that accounts receivables could rank as good security and credit against such assets could be extended in all appropriate cases, instead of the same being confined only to a privileged few, it is necessary that the legal framework should facilitate assignment of accounts receivables in favour of banks and other financing institutions.

2.4.6 At present, the transferee of an actionable claim takes it subject to all the liabilities and equities to which the transferor was subject in respect thereof at the date of the transfer.[1] Hence, the value of a general assignment of an account receivable of a borrower cannot be properly assessed as this requires an examination by the financing institution of all the details in the contract between the borrower and the obligor under the account receivable. In order to encourage the development of factoring business and improve the status of contract rights as good security, at least with reference to cases where the obligor on the account receivable and the bank's borrower agree that on the assignment by the borrower of the obligation, the obligor will not raise against the assignee-bank any claim or defence which he may have against the borrower.

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[1]Section 132 of the Transfer of Property Act, 1882.

2.4.7 If an assignment free from such defences is legally provided for, then commercial concerns may, while extending credit to their customers, provide a standard clause in the agreement that in the event of an assignment of the claim, the customer is not entitled to assert against the assignee any claim or defence he may have against the commercial concern. The claims comprised in such agreements can be bunched together and assigned in favour of a bank or other financing institution or a factoring institution.

2.4.8 Hence, we recommend that an agreement by an obligor on a general intangible not to assert against the assignee any claim or defence that he has against his seller or lessor is enforceable by the assignee who takes the agreement for value, in good faith and without notice of such claim or defence. However, this provision need not apply to any claim in respect of consumer goods. This provision shall not also affect defences which may be asserted against a holder in due course of a negotiable instrument.

NO COMMERCIAL DISTINCTION BETWEEN SALE OF AN ACCOUNT RECEIVABLE AND ITS ASSIGNMENT AS SECURITY

2.4.9 As we mentioned earlier, advances against book debts or general intangibles by banks in our country, following the pattern in other countries, take the form of either an outright assignment (sale) or as one intended as security. The framers of the Uniform Commercial Code of the U.S.A. have also observed that "commercial financing on the basis of accounts and chattel paper is often so conducted that the distinction between a security transfer and a sale is blurred".[1] Profs. R. M. Goode and L.C.B. Gower, the U.K. authorities on the subject, have also observed that "the distinction between an assignment and a mortgage of accounts is unreal and that both should be brought within the framework of a single personal property security law".[2] Hence, it is necessary that our statutory scheme dealing with the personal property security law should cover both a sale of an account receivable as well as an assignment thereof as security.

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[1]Official Comment to section 9-102 of the Uniform Commercial Code (1972 version).

[2]"Is Article 9 of the Uniform Commercial Code Exportable ? An English Reaction" by R. M. Goode and L. C. B. Gower, Aspects of Comparative Commercial Law, McGill University, Oceana Publications Inc. (1969), p. 347.

ASSIGNEE'S ACCOUNTABILITY

2.4.10 However, the legal consequences flowing under both circumstances, namely,—

(a) when assignment purports to be an absolute sale, and

(b) when assignment is intended as a security,

have to be clearly brought out. In the case of the former, the assignee or the secured party shall be under no accountable obligation to the debtor. However, it is necessary to provide for such accountability in the case of the latter.

RULE OF PRESUMPTION

2.4.11 It is also necessary to provide a rule of presumption to facilitate determination of the circumstances when an assignment should be considered as an absolute one and when it shall not be so regarded. Following the commercial practices in our country and the position in other countries, the statute should provide that where the agreement provides for assignment of an instrument or a general intangible but does not expressly specify whether it is with or without recourse to the debtor, it shall be presumed to be an assignment with such recourse.

DIRECT *VS.* INDIRECT COLLECTION

2.4.12 In a direct collection, the assignee of an account receivable notifies the account debtor who is required to make payment directly to the assignee. Under the indirect collection method, the borrower continues to receive the payments from the account debtor and may be transmitting the same to the assignee. In the latter case, the account debtor need not be concerned with the rights *inter se* between the borrower/assignor and the secured party/assignee. Commercial and banking convenience requires that the statutory framework should enable both the methods to function, leaving it to the choice of parties to decide which method they would like to adopt. Hence, it is necessary that the statutory framework of our personal property security law should provide clear-cut rules to facilitate the application of both the direct method of collection and the indirect method of collection.

RIGHT OF COLLECTION

2.4.13 However, the assignee's right of collection will also depend on the question whether or not the assignment is with or without

recourse to the debtor. Where the assignment is without recourse to the debtor and in any event upon default, the secured party should be entitled—

(a) to require the obligor on a general intangible to pay to the secured party further amount, if any, due from the obligor, by giving him a notice in writing whether or not the assignor was theretofore making collections on the property; and

(b) to take over any proceeds to which the secured party is entitled.

Where the assignment is without recourse to the debtor and in any event upon default, the secured party should be entitled to take steps to collect the further amounts, if any, due from the obligor and to take over any proceeds to which he is entitled, but the obligor may recognise the secured party's claims only subject to the provisions of any applicable law governing the assignment and payment.

2.4.14 However, where the assignment is with recourse to the debtor and the assignee collects from the obligor on a general intangible or an instrument, he should be required to proceed in a reasonable manner, but he should be entitled to deduct his reasonable expenses of collection.

2.4.15 Any payment in good faith, by an obligor on a general intangible or instrument, to the debtor or his assignee after he is notified of the assignment shall be valid against any person claiming a security interest in respect of the general intangible or instrument.

PERFECTION OF A SECURITY INTEREST IN ACCOUNTS RECEIVABLES

2.4.16 Already the Companies Act, 1956, provides that a charge on the book debt of a company is registrable under section 125 of that Act. On similar lines we are suggesting elsewhere for registration of security interests in the accounts receivables of a company.

2.4.17 As regards firms and sole proprietary concerns also we are recommending special provisions to enable registration of a charge against their accounts receivables. This should considerably facilitate giving credit against accounts receivables to small borrowers like retailers, traders and merchants who are vast in number in the business community and who do business without incorporation.

RECONCILIATION OF SECURITY INTERESTS IN INVENTORY *VS.* SECURITY INTERESTS IN ACCOUNTS RECEIVABLES

2.4.18 The protection of a security interest in an acccount receivable shall not affect a financing institution which has advanced against the inventory, the sale of which has given rise to the account receivable. Hence, it should be provided that the security interest of a transferee of a general intangible resulting from sale, lease or exchange of goods should be subordinate to a security interest which was already a perfected security interest when the goods became the subject of sale, lease or exchange.

CHANGES TO EXECUTORY CONTRACTS MADE IN GOOD FAITH

2.4.19. Generally the law should be flexible and allow reasonable modifications in the agreement between the account debtor and the borrower/assignor which will not materially affect or abridge the interests of the assignee/secured party.

2.4.20 In executing turn key projects and large building and such other contracts, numerous sub-contracts are also entered into. The performance of the contract may be financed by a bank or a financing institution. If, for every small change or modification in the sub-contract or any small change in the contract between the borrower/assignor and the person for whose benefit the contract is performed, the prior consent or concurrence of the secured party/assignee of the contract right is required, then the transaction could not be expeditiously implemented nor will it be commercially convenient. While this is a matter that could be decided by agreement between the assignor and the assignee, where the contract is silent the law should permit reasonable *bona fide* modifications or substitutions in the performance contract. A provision on these lines would considerably facilitate and save unnecessary expense in bank advances for execution of big contracts for building factories, turn key projects, etc.

2.4.21 Hence, the statute should provide that so long as the right to claim payment under an assigned contract has not fully accrued by performance, and notwithstanding notice of the assignment, any modification of or substitution in the contract made in good faith and in accordance with reasonable standards and without material adverse effect upon either the assignee's right or the assignor's ability to perform the contract should be effective against the assignee and the assignee shall acquire corresponding right under the modified or substituted contract.

2.4.22 But the assignee/secured party shall have the choice to decide whether he would permit such modification or not. In the event of his deciding not to permit it, it shall be open to him to provide in the security agreement constituting the assignment that any modification or substitution of the executory contract shall be regarded as a breach committed by the assignor.

CLOG ON ASSIGNMENT OF ACCOUNTS RECEIVABLES

2.4.23 In order that financing against accounts receivables may develop, it is necessary to provide, on the lines of provisions found in comparable models, that a term in any contract between a debtor on a general intangible and an assignor which prohibits assignment of the debt is ineffective.

CONSEQUENTIAL CHANGES IN THE TRANSFER OF PROPERTY ACT

2.4.24 Consequent on the recommendations with reference to advances against accounts receivables, some changes are necessary in the provisions of the Transfer of Property Act, 1882. They are indicated in items 2 and 3 of the Second Schedule to the draft Bill which contains in a comprehensive form the recommendations of this Committee with reference to our personal property security law.

CHAPTER 5

SPECIAL PROVISIONS TO BANKS REGARDING CERTAIN TYPES OF ADVANCES

Banks and financing institutions, as we earlier mentioned, are primarily animated by the desire to fulfil certain socio-economic objectives. Hence, special recognition may have to be given to banks in our credit-security laws. The credit-security laws of several countries provide for such recognition. In our country also, in general enactments, both of the Union and of the States, there is such recognition. It is necessary that banks are given special recognition also in the statutory scheme to govern transactions secured against personal property.

TEMPORARY PERFECTION IN FAVOUR OF BANKS

2.5.2 Advances by banks under certain circumstances may have to be treated as creating in their favour a perfected security interest for a temporary period without the necessity for banks taking possession of the security or registration of their security interest. In Chapter 2 of Part I, we traced the developments in our country so far to facilitate trust receipt type of transactions which are vital for our international trade. There, we noticed the earlier attempts starting from the recommendation of the Central Banking Enquiry Committee (1931) for enhancing the status of trust receipt. The Uniform Trust Receipts Acts of the U.S.A. which were considered earlier in our country as the model for legislation, have since been replaced and the concepts therein have now been further refined, in the U.S.A., by the Uniform Commercial Code. Under both these schemes, trust receipt type of transactions are treated as temporarily perfected for a specified duration without the necessity for the bank to obtain possession of the goods or the need for registration.

2.5.3. In the light of the earlier discussion on the subject and in order to facilitate trust receipt transactions and make them available to the comparatively smaller class of borrowers, it is necessary to provide that—

(1) when the secured party is a bank and gives, under a written security agreement, value, not being an antecedent debt or a liability, a security interest in an instrument or a negotiable document of title connected with such value shall be deemed

to be perfected without the taking of possession of the instrument or document, for a period of thirty days from the date on which the bank gives such value;

(2) a perfected security interest held by a bank in—

(a) an instrument which the secured party delivers to the debtor for the purpose of—

(i) ultimate sale or exchange, or

(ii) presentation, collection or renewal, or

(iii) registration of transfer, or

(b) a negotiable document of title, or goods held by a bailee and not covered by a negotiable document of title, which document of title or goods the secured party makes available to the debtor for the purpose of—

(i) ultimate sale or exchange, or

(ii) loading, unloading, storing, transporting shipping or transhipping, or

(iii) manufacturing, processing, packaging or otherwise dealing with the goods in a manner preliminary to their sale or exchange,

remains perfected for a period of thirty days after the property comes under the control of the debtor, but priority between conflicting security interests in the goods is subject to the preference under the scheme as regards purchase money security interests in inventory; and

(3) after the expiry of the abovesaid thirty day period, perfection should depend upon compliance with the other applicable provisions of the statute.

CURRENT CROP LOANS BY BANKS

2.5.4 Earlier we have referred to the necessity for a statutory provision to provide for priority for current crop loans advanced by banks. This is in recognition of the fact that such special priority should be available only to banks and not for mere moneylenders who do not extend purpose-oriented credit.

UNPERFECTED SECURITY INTERESTS IN FAVOUR OF BANKS IN THE ASSETS OF FIRMS AND PROPRIETARY CONCERNS

2.5.5 Security interests of banks could easily be perfected when they are with reference to companies or when they are made with reference to fixtures or motor vehicles or crops. But when banks grant advances to firms and proprietary concerns and not against fixtures or motor vehicles or crops, the position requires special consideration.

REGISTRATION ONLY OPTIONAL

2.5.6 Under the scheme which we are recommending, it would be possible for banks to register their security interests when their advances are made to firms or proprietary concerns under the suggested new Part III-A of the Registration Act, 1908. While registration under Part III-A should be available to banks at their option, they should not be under a compelling necessity to effect such registration in order to get the remedies against the security, which are available to perfected security interest holders. This is due to the following circumstances :

(i) The pressure on the registration machinery pursuant to Part III-A should not be considerable at any point of time, having regard to the number of firms and proprietary concerns in the whole country ;

(ii) it may be taken as a reasonable expectation that a person dealing with a firm or proprietary concern could assume that the assets of the concern, in whole or in part, would be subject to a security interest in favour of its banker ; and

(iii) advances by banks to firms and proprietary concerns would be advances for purchase money and hence though unregistered, their advances may merit special status in the framework of the personal property security law.

However, whenever a bank considers it desirable, optional registration should be available to it regarding its security interest in the assets of a firm or a proprietary concern.

EFFECT OF INSOLVENCY, *ETC.*

2.5.7 It is also necessary to have clear provisions stating the effect of insolvency of the debtor, subsequent purchase of the property in good faith for value, and the claims of unsecured creditors. In all such cases, it is necessary to protect the rights of a person having a

perfected security interest in the property. Hence, we are recommending that the claims of a secured party having a security interest in the property should be subordinate to—

(i) the claims of a subsequent purchaser of the property where the purchase was in good faith for value without knowledge of the unperfected security interest,

(ii) the claims of an unsecured creditor who, whether before or after the creation of an unperfected security interest, gets the property attached through judicial proceedings, and

(iii) the claims of the official assignee, receiver in insolvency or liquidator in a winding up,

unless, at the time when a claim arises under any of the above items, he has a perfected security interest in the property.

PREFERENCE TO BANKS REGARDING UNPERFECTED SECURITY INTERESTS

2.5.8 The special position of banks merits statutory recognition. Even as regards unperfected security interests in the assets of firms and proprietary concerns, priority should be given to the security interest of a bank where the property is not a motor vehicle, fixture or crops. Hence, we are recommending that the general rule of subordination of an unperfected security interest in dealing with claims referred to in items (i) to (iii) of paragraph 2.5.7 shall not apply when the secured party is a bank having an unperfected security interest in the property which is not a motor vehicle or a fixture or crops and the debtor is not a company. In such a case, the security interest of a bank is protected. This provision should considerably facilitate small business people in availing themselves of bank credit.

ENFORCEABILITY RE. SECURITY INTERESTS IN FAVOUR OF BANKS WHETHER PERFECTED OR UNPERFECTED

2.5.9 As regards the enforceability of a security interest in favour of a bank, it is also necessary and desirable, following from the discussion above, not to make any distinction based on the nature of the security interest, that is, whether it is perfected or unperfected. On the contrary, with reference to an unperfected security interest in favour of a secured party other than a bank, certain special rights which allow him to proceed against the secured property directly or without recourse to court should not be extended. Thus, in the scheme we are recommending, the right to take possession of the property without recourse to court, the right to dispose of the property in the event of

default and the right to appoint a receiver are being given only to perfected security interest holders and to banks irrespective of whether their security interests are perfected or not.

MAGISTERIAL ASSISTANCE FOR BANKS TAKING POSSESSION OF THE PROPERTY

2.5.10 Banks are by and large socially controlled and are publicly owned. They grant advances from out of the public deposits and other public funds. It is already recognised that the assets of banks should be protected and for this purpose the Banking Regulation Act, 1949, contains certain provisions. There are also now certain provisions under the Industrial Finance Corporation Act and the State Financial Corporation Act to help the lending institutions in proceeding against the secured property.

2.5.11 We consider that there should be a common provision available to banks and term-lending institutions which would facilitate their proceeding against the secured property in the event of default by the borrower. Timely action to preserve the secured property is necessary especially with reference to advances against movable assets. Since public funds are involved, it is natural that the State help should be available to banks and term-lending institutions in seeing that the secured property is not secreted away or is otherwise fraudulently disposed of by the defaulting borrowers.

ANALOGY OF SECTION 45S OF THE BANKING REGULATION ACT

2.5.12 Section 45S of the Banking Regulation Act, 1949, provides that a banking company in liquidation may seek the assistance of the Metropolitan Magistrate or the District Magistrate, as the case may be, to realise its assets. Action under Section 45S is also not liable to be questioned before any court or other authority. The action is essentially for the protection of the property and it will be without prejudice to the rights of parties. But this provision is now applicable only when the bank has ceased to be a going concern.

2.5.13 While it is essential and desirable to extend the principle of Section 45S *ibid* to cover advances made by banks and term-lending institutions even as they function as going concerns so that they can obtain the effective help of the authorities to get possession of the secured property on the default by the borrower, it is not necessary

that the proceedings should be placed beyond the pale of judicial review. In view of the above, it is necessary to have a specific provision in our personal property security law on the following lines :

(1) A bank may request, in writing, the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, within whose jurisdiction the property is situate or is found, to assist the bank in taking possession of the property or the document relating thereto in the case of a general intangible, and the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, as the case may be, shall, on such a request being made to him assist the bank in taking possession of the property or the document relating thereto in the case of a general intangible.

(2) For the purpose of securing such compliance, the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, as the case may be, may take or cause to be taken such steps and use or cause to be used such force as may, in his opinion, be necessary.

CHAPTER 6

REGISTRATION MACHINERY

There is necessity for a simple and inexpensive registration machinery for recording security interests in all forms of movable assets including fixtures and crops. It would be ideal if, employing computerised technology, a central registry could be established for recording all forms of security interests in personal property, at least at the State level. The establishment of a central registration machinery will, however, take a long time. While efforts may have to be made towards the establishment of a central registration machinery, law reform cannot wait until this happens.

2.6.2 The project study on personal property security law has rightly emphasised the necessity for continuing the efforts to develop a central registration machinery which will avoid the necessity of security interests with reference to different forms of assets and different types of borrowers being recorded at different places. But the project study has also pointed out the fact that such a central registration machinery is not feasible, nor is it immediately necessary in our country for the development of a comprehensive scheme of personal property security law.

COMPREHENSIVE VISION RE. REGISTRATION OF SECURITY INTERESTS

2.6.3 What is immediately necessary for the development of a comprehensive scheme of personal property security law is a comprehensive legal vision of the scope and operation of the registration machineries now available with reference to registration of security interests in personal property.

AVAILABLE REGISTRATION MACHINERY

2.6.4 At present, a security interest in the assets (including movable assets) of a company is required to be registered with the Registrar of Companies. There is now provision for recording a hire-purchase interest or hypothecation charge in respect of a motor vehicle in the certificate of registration issued by the authorities under the Motor Vehicles Act, 1939. Under the Registration Act, 1908, there is now provision, which is rarely used, for registering with the Sub-Registrar

of Assurances instruments (other than wills) which purport or which operate to create, declare, assign, limit or extinguish any right, title or interest to or in a movable property.[1]

VARYING CONSEQUENCES ON NON-REGISTRATION

2.6.5 The effect of registration or non-registration of a security interest pursuant to the aforesaid provisions is also now vastly different. Non-registration under the Companies Act provisions makes a security interest void against the liquidator and any creditor of the company. If a security interest in a motor vehicle by way of hire-purchase/hypothecation is not recorded, it does not as such have any adverse effect, though it exposes the security interest holder to the possible loss of the security by reason of the vehicle being transferred to third persons who may take it without any knowledge of the security interest in favour of the hire-purchase financier/hypothecatee. Non-registration of a hire-purchase financier's interest does not now legally (under the instalment sale concept) affect him though it may affect his ability to trace the vehicle in the event of default. Non-registration of a fixture charge may avoid the creation of a security interest were a court is to view the fixture as having ceased to be a movable asset. Non-registration of a charge on other movable assets under the provisions of the Registration Act [section 18(d)] does not deny any positive advantage except probably that registration helps to establish in some doubtful cases the genuineness of the security agreement. These differing and varying consequences of non-registration adversely affect proper recognition of the functional role of security.

ALL REGISTRATION TO BE VIEWED AS PART OF ONE SCHEME

2.6.6 Now these different machineries available for registration of security interests in personal property have to be viewed as parts of a whole and well-knit scheme in order that the functional role of security in the development of the economy could be fully employed. To this end, the requirement as to registration as well as consequences of non-registration will have to be suitably adapted having regard to practical circumstances. With such basic approach, we may now consider the role of registration machineries under the Companies Act, the Motor Vehicles Act and the Registration Act.

2.6.7 It is obvious that necessary changes will have to be made to the applicable provisions and some administrative adjustments ensured for the efficient functioning of the registering authorities with a view to help economic development and to facilitate the disbursement of

[1]Section 18(d).

credit for the priority sectors and for the smaller and weaker sections of the borrowers. Now, we shall consider the different registration machineries at present available for registering security interests in personal property.

REGISTRATION UNDER THE COMPANIES ACT

2.6.8 Under the Companies Act, what is recorded is the security interest and not the instrument creating the security interest. This contrasts with the scheme of the Registration Act where what is recorded is the instrument creating the security interest. The difference becomes apparent when we find that a security interest is created without any formal document, *e.g.*, mortgage by deposit of title deeds with reference to an immovable property could be registered under the Companies Act. Since there is no instrument evidencing its creation, the question of registration with reference to this mortgage under the Registration Act does not as such arise.

COMPANIES ACT SCHEME MORE RATIONAL

2.6.9 The principle underlying the registration provisions of the Companies Act is more rational and useful. Again, in the scheme of personal property security law which we are recommending, except security interests which are perfected by taking possession of the secured property, in all other respects they have to be evidenced by a writing. But having regard to the nature of transactions concerning security interests in movable property, registration of security agreements will pose numerous administrative difficulties. Nor is registration of *security agreements* (as opposed to registration of *security interests*) necessary. Hence, under the scheme of our personal property security law, for the purpose of perfecting a security interest, a recording of the particulars regarding the security interest with the appropriate authority is all that is necessary. Such recording of the security interest in a public register or a public document will enable third persons dealing with the secured property to become aware of the claims of the secured party.

MINIMAL CHANGES TO THE COMPANIES ACT

2.6.10 We are suggesting minimum changes to the existing provisions of the Companies Act. A few changes are suggested to make the registration under the Companies Act more effective. Though under that Act a period of thirty days has been given for filing an application for registration of a charge, public notice of the charge does not happen until actual registration. Special provision is required to cover the period between the filing of the application and the actual entry in the register about the security interest. Hence, we are suggesting a

provision that, immediately on the filing of the particulars, the Registrar shall make a provisional entry in the register showing that an application has been filed with him and indicating the nature of the transaction, the names and addresses of the parties thereto and the description of the property to which the transaction relates. Consequent to this provision, we are also suggesting that, for ascertaining the date from which notice of the charge shall be presumed, it is the date of the provisional entry that should be considered.

REGISTRATION OF SECURITY INTEREST IN PERSONAL PROPERTY UNDER THE REGISTRATION ACT, 1908

2.6.11 While considering registration of security interests in personal property with the authorities constituted under the Registration Act, 1908, we will have to keep in view the following factors :

(1) There is a void at present with reference to the creation of security interests in the personal property of firms and proprietary concerns — this can be filled only by appropriately adapting the registration machinery set up under the Registration Act, 1908.

(2) The requirements with reference to registration of security interests in the personal property of firms and proprietary concerns will have to be considerably simplified and should be capable of being complied with with the minimum of formalities and administrative effort.

(3) There has to be some indication of the place where registration is required to be made so that persons dealing with the firm or sole proprietary concern may reasonably be aware of the place where such security interests would have been recorded.

(4) With reference to fixtures and crops which are linked with the land, the appropriate authority with whom registration of the security interests in respect of such assets is to be made should be the authority having territorial jurisdiction over the land.

Having regard to the above considerations, we have suggested a new Part (Part III-A) in the Registration Act, 1908. Here we may add that even while the registration scheme under the Registration Act, 1908 and the earlier statutes were introduced in our country, it was the intention to develop the registration scheme to cover also transfer of movable assets. It was intended to be done gradually. But the complexities of the situation have resulted in the postponement of this

development so far. Time is now ripe for toning up of our registration scheme to provide for registration of security interests in personal property since thereby our credit-security law could effectively contribute to economic development.

PLACE OF REGISTRATION

2.6.12 Registration of a security interest in personal property (other than fixtures and crops) may be effected only in the office of the Registrar in whose district the debtor ordinarily carries on business or if he does not carry on business, where he ordinarily resides. A debtor who has a Permanent Account Number for purposes of Income-tax shall be deemed to carry on business at the place where he has the Permanent Account Number.

2.6.13 Under the Registration Act, the Registrar is the District Registrar and hence search for security interests over the assets of firms and proprietary concerns (other than fixtures and crops) could be made in the District Registrar's office for the whole district. This will considerably eliminate the difficulties that would otherwise be caused if the register with reference to a district is to be split up among different sub-registries.

APPLICATION FOR REGISTRATION

2.6.14 An application for registration of a security interest in personal property other than a fixture or a crop, shall be signed and attested in the manner prescribed and shall contain the following particulars:

(a) the name, description and address of the debtor;

(b) the name, description and address of the secured party;

(c) the date of execution of the security agreement;

(d) a description of the personal property sufficient to identify it;

(e) the amount secured under the security agreement; and

(f) such other particulars as may be prescribed.

REGISTRATION IN A NEW BOOK

2.6.15 For registration of security interests in personal property, other than fixtures and crops, the District Registrar should be required to open a separate book wherein he can record the particulars of the security interests. The register should be a nominally indexed register, giving also reference to the Permanent Account Numbers, if any, for those with reference to whose assets applications have been made for recording security interests therein.

POSITION OF BANKS

2.6.16 As we pointed out in the earlier Chapter, banks need not necessarily register their security interests with the Registrar. However, where they find that it would be desirable to have it done to protect their priority *vis-a-vis* other conflicting security interests, they may do so.

BOOK NO. 6

2.6.17 The register, which may be numbered as Book No. 6, shall be available to the public for inspection and *searches* therein may be provided by rules. Registrars may also be authorised to issue *certificates regarding encumbrances* noted in Book No. 6 in the name of the indexed borrower, in an appropriate form that may be prescribed by Government.

REGISTRATION BY POST

2.6.18 Under the scheme of the personal property security law, the role of the Registrar will be that of a recording officer and he is not required to go into the veracity of the statements. Hence, it is unnecessary to require personal attendance of the parties before the Registrar, unless the parties choose to do so.

2.6.19 Already the Co-operative Societies Acts provide for a land development bank sending to the Sub-Registrar copy of an instrument creating a mortgage in its favour in land and for the Sub-Registrar filing such document in Book No. 1.[1] Similar procedure is followed regarding a certificate of sale of immovable property issued by a court.[2] This principle merits extension, particularly when we are contemplating not registration of the documents but recording of the security interests, particulars of which may be filed in the prescribed form before the Registrar.

2.6.20 Hence, notwithstanding anything contained in the other provisions of the Registration Act, 1908, an application for registration of a security interest in personal property should be permitted to be sent by registered post. The Registrar should also be required to send the certificate of registration by registered post at the cost of the applicant. The rules may provide the manner for payment of the registration charges that may be incurred by the Registrar.

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[1]Section 122 of the Maharashtra Co-operative Societies Act (vide questions Nos. 15.16.2 and 15.16.3 of the questionnaire).

[2]Section 89(2) of the Registration Act, 1908.

REGISTRATION OF SECURITY INTERESTS IN FIXTURES AND CROPS

2.6.21 A security interest in a fixture or crop has to be registered with the Sub-Registrar of Assurances in whose territorial jurisdiction the land to which the fixture is affixed or on which the crop is grown is situate.

2.6.22 The registration of a security interest in a fixture or crop should be effected generally in the manner that would be provided for with reference to application for registration of a security interest in other forms of personal property. It should also be possible to effect such registration by post.

2.6.23 But the entry of the fixture charge or the security interest in the crop will have to be made by the Sub-Registrar in the book maintained by him for recording transactions in immovable property, that is, Book No. 1. If necessary, to facilitate the entry regarding security interests in fixtures and crops, appropriate rules may be framed by Government.

PROVISIONS INAPPLICABLE

2.6.24 Consistent with the scheme regarding registration of security interests in personal property, the elaborate requirements specified in the Registration Act, such as calling personal attendance of the parties, and requiring an admission from them of the passing of consideration, genuineness of the signature, awareness of the nature of the transactions, *etc.*, are all unnecessary. Hence, these and such other provisions are, in the statutory scheme proposed by us made inapplicable to registration of security interests in personal property.

REGISTRATION UNDER THE MOTOR VEHICLES ACT

2.6.25 Even now, a hire-purchase lender or a hypothecatee-bank gets his security interest noted in the certificate of registration of a motor vehicle pursuant to the provision made in 1970[1] in the Motor Vehicles Act, 1939. Even before the coming into force of section 31A, in some States, like Kerala, provision has been made for noting in the certificate of registration the security interest of the hire-purchase lender. The motor vehicles authorities in all the States now keep a register of the certificates of registration of vehicles registered with them under a card index system. These registers are now maintained in the district centres. When a transfer of registration is sought within a State, the registration card is also transferred to the other district.

[1]Section 31A.

But when a vehicle's registration is sought to be transferred from one State to another, it involves a re-registration in the other State and cancellation of registration with the authorities in the original State. Thus, we have a fairly satisfactory machinery for recording security interests in motor vehicles.

2.6.26 What is required is only to strengthen the legal frame-work regarding registration of a security interest in the certificate of registration. In this process, it has to be ensured that there is no appreciable additional administrative burden involved. This is necessary having regard to the number of motor vehicles and the need to ensure expedition in getting information regarding security interests over motor vehicles.

2.6.27 We have earlier suggested a provision for temporary perfection of a security interest for purchase money over a chassis to extend also to the body that may be built thereon. During this temporary period it should not be ordinarily necessary to obtain a certificate of registration when the vehicle is in the form of chassis only. In rare cases where the nature of body to be built on the chassis and other attendant factors require a longer time beyond three months, it should be open to the financing institution to get the temporary certificate of registration pursuant to section 25 of the Motor Vehicles Act, 1939, and have its interest noted therein.

2.6.28 We have also earlier referred to the specific provision we are recommending in the scheme of the personal property security law to give formal legal recognition to the commercial practice of regarding the certificate of registration of a motor vehicle as a document of title in respect of such vehicle.

2.6.29 In the Chapter dealing with purchase money security interests over motor vehicles, we have also referred to the desirability of ensuring that at any point of time only one security interest is allowed to remain perfected with reference to a motor vehicle, in order that in the event of default there may be no scramble for possession and having regard to other relevant factors.

2.6.30 We have also recommended—

(a) for cancellation of a security interest noted in the certificate of registration ;

(b) provision for obtaining the consent of the secured party when there is a transfer of ownership of a motor vehicle

which is subject to the security interest noted in the certificate of registration and when there is an application for issue of a duplicate certificate of registration ; and

(c) the issue of a fresh certificate of registration (not a mere duplicate thereof) in the name of the secured party having a registered security interest, when such a person is able to satisfy the registering authority that he has taken possession of the vehicle being entitled to do so owing to the default of the owner.

Consistent with the scheme of the provisions for recording a security interest in the certificate of registration, we have also suggested some amendments to the provisions of the Motor Vehicles Act to protect the security interest of a secured party to keep him aware of any factors which are likely to adversely affect his interest.

CHAPTER 7

RIGHTS, OBLIGATIONS AND REMEDIES OF PARTIES

In considering the rights and remedies that should be available claim and its assignment by way of security is so blurred that to the following factors:

(1) The special position of banks and allied financial institutions which are required to extend credit based on certain priorities and other policies laid down by the credit planning authorities, which have to be suitably recognised in the framework of the personal property security law;

(2) while the rights of parties to have access to courts to have their rights and remedies should not be curtailed, the legal framework should minimise the occasions for recourse to judicial proceedings for settling the rights of parties;

(3) with reference to persons other than banks, while registered security interest holders may be given rights to proceed against the property directly and without recourse to court, as regards unregistered security interest holders it may not be desirable or necessary to confer on them such rights;

(4) with reference to persons who are in possession of the secured property, the law now enables such pledgees to dispose of the property directly and without recourse to court in the event of default—it is necessary to preserve this right; and

(5) the law should also recognise certain basic rights in the debtor-borrower so that unconscionable or unreasonable transactions or arrangements operating to his prejudice are not encouraged.

Having regard to the aforesaid considerations, we have suggested specific provisions.

2.7.2 The rights of the secured party arising in the event of default, or rights which may be conferred by agreement and which may be exercised even before default, may relate to the following:

(i) right to take possession upon default, including the right to remove accessions or fixtures;

(ii) right to have a receiver appointed;

(iii) right over instruments and general intangibles;

(iv) right to dispose of the property upon default; and

(v) court's power to appoint a receiver.

(i) SECURED PARTY'S RIGHT TO TAKE POSSESSION IN THE EVENT OF DEFAULT

2.7.3 The right to take possession of the secured property upon default shall be available to banks and all registered security interest holders. In taking possession, the secured party may proceed without judicial process if this can be done without breach of peace or he may apply to the court for taking possession. If the secured party happens to be a bank, it can invoke the assistance of the authorities pursuant to the provisions earlier we have recommended.

2.7.4 If the security agreement so provides, the secured party may require the debtor to assemble the property and make it available to the secured party at a place to be designated by the secured party, which is reasonably convenient to both the parties.

2.7.5 With reference to registered security interests, the secured party may also reasonably render the goods in the possession of the debtor temporarily unusable. But this provision shall not apply to consumer goods or inventory.

2.7.6 We referred earlier to the provisions that should be available to the secured party for the removal of the accession or fixture and the manner of reconciliation of the rights of the security interest holder in the accession/fixture with one claiming an interest in the principal goods/the land to which the machinery is affixed.

(ii) APPOINTMENT OF A RECEIVER

2.7.7 The right to appoint a receiver may be provided for in the security agreement but shall be capable of being exercised only by banks and all perfected security interest holders. With reference to such appointment of receiver, we have suggested a suitable provision.

(iii) SECURED PARTY'S RIGHTS OVER INSTRUMENTS AND GENERAL INTANGIBLES

2.7.8 In the Chapter dealing with credit against actionable claims and other intangibles we already referred to the principal methods of obtaining a security interest over an actionable claim or other intangible—the direct collection method and the indirect collection method—which may be either with recourse or without recourse. We

also indicated therein how the distinction between a sale of an actionable claim and its assignment by way of security is so blurred that in order to be of real assistance the credit-security law has to deal with both an absolute assignment and an assignment by way of security. In that Chapter we indicated the respective rights that should be available to the assignor and the assignee of a general intangible.

(iv) SECURED PARTY'S RIGHT TO DISPOSE OF THE PROPERTY UPON DEFAULT

2.7.9 The right to dispose of the property upon default will be available to banks and all perfected security interest holders. The secured party may dispose of the property in its then condition or after any reasonable repairing, processing or preparation for disposition.

2.7.10 The proceeds of disposition shall be applied in the following order:

(a) the reasonable expenses of holding, repairing, processing, preparing for disposition and disposing of the property and, to the extent provided for in the security agreement and not prohibited by law, any other reasonable expenses incurred by the secured party;

(b) the satisfaction of the obligation secured by the security interest of the party making the disposition; and

(c) the satisfaction of the obligation secured by any subordinate security interest in the property, if written demand therefor is received by the party making the disposition before the distribution of the proceeds is completed:

Provided that before satisfying the obligation of the subordinate security interest holder, the secured party shall give notice of such written demand to the debtor and if the debtor, within twentyone days from the date of receipt of the notice, expresses his objection to such satisfaction, the secured party shall deposit the surplus proceeds in the court having jurisdiction in accordance with the provisions of the statutory scheme.

2.7.11 The interest of subordinate security interest holders should be suitably safeguarded. They may be asked to furnish reasonable proof before their claims are considered.

2.7.12 A secured party, who is entitled to dispose of the property without recourse to court, shall also be entitled to dispose of the property without taking possession of the same. In other words, such

a creditor should be capable of assigning the title to the property without taking possession of the property by a transaction which is otherwise *bona fide*. A provision facilitating such a procedure will considerably help banks and financing institutions to concentrate on disbursement of credit for productive purposes and save them from the worries regarding realisation of the security by selling the property to persons who may be willing to take the several steps and other allied measures which may be necessary to perfect their title.

2.7.13 Methods of disposition have to be reasonable and should be in accordance with commercial practice. But the disposition may be by public sale, private sale, lease or otherwise. Subject to suitable notice being given to the debtor, the disposition may be at any time and place and on any terms so long as every aspect of the disposition is reasonable. The secured party shall dispose of the property in whole or in part within a reasonable time and may retain the secured property till then.

NOTICE OF DISPOSITION

2.7.14 The debtor should be given suitable notice before the secured party entitled to disposal of the property without recourse to court exercises his right to do so. But this rule as regards notice need not be observed where the secured property will decline speedily in value or is of a perishable nature. This notice has to be given to the debtor and to any other person who has a registered security interest in the property or about whose security interest in the property the secured party is already aware. Not less than fifteen days' notice in writing is necessary.

WHAT THE NOTICE SHALL CONTAIN

2.7.15 The notice from the secured party proposing to dispose of the property in the event of default shall contain the following particulars:

(a) a brief description of the property;

(b) the amount required to satisfy the obligation secured by his security interest;

(c) the sums actually in arrear, exclusive of the operation of any acceleration clause in the security agreement, or a brief description of any other provisions of the security agreement for the breach of which the secured party intends to dispose of the property;

(d) the amount of the applicable expenses, or in a case where the amount of such expenses has not been determined, his reasonable estimate thereof;

(e) a statement that upon payment of the amounts due under (b) and (d) above the debtor may redeem the property ;

(f) a statement that upon payment of the sums actually in arrear or the curing of any other default, as the case may be, together with the amounts in default the debtor may reinstate the security agreement ;

(g) a statement that unless the property is redeemed or the security agreement is reinstated the property will be disposed of and the debtor may be liable for any deficiency ; and

(h) the date after which any public sale or private disposition of the property is to be made.

The notice shall be sent by registered post acknowledgement due to the latest known postal address.

SECURED PARTY'S RIGHT TO PURCHASE THE SECURED PROPERTY

2.7.16 With the permission of the court, which may be given subject to conditions, the secured party may purchase the property or any part thereof at a public sale.

EFFECT OF DISPOSITION

2.7.17 Where the property is disposed of by the secured party without recourse to court in accordance with his rights, the disposition shall discharge the security interest of the secured party making the disposition. If such disposition is made to a *bona fide* purchaser for value, it shall also discharge any subordinate security interest and terminate the debtor's interest in the property. A *bona fide* purchaser for value under such disposition shall take free from all such security interests even though the secured party fails to comply with any requirements to be observed in making the disposition. In the case of a public sale, to get such protection the purchaser shall have no knowledge of any defects in the sale and he should not buy the property in collusion with the secured party, other bidders or the person conducting the sale.

(v) COURT'S POWER TO APPOINT A RECEIVER

2.7.18 On the application of the secured party or the debtor or any person having an interest in the property, the court may appoint a receiver on such terms and conditions as it may specify, if it considers such appointment just and necessary.

RIGHTS OF THE BORROWER

2.7.19 In all civilised jurisdictions, notwithstanding any contract to the contrary, the right of the debtor or the borrower to redeem the property at any time before the disposal of the property is recognised. Already the provisions of our Transfer of Property Act recognise this principle with reference to immovable property. With equal force its recognition has to be given in a statutory scheme with reference to movable property.

2.7.20 Hence, at any time before the secured party has disposed of the property by sale or exchange or contracted for such disposition, the debtor or any person other than the debtor who is the owner of the property, or any secured party other than the secured party in possession, may either—

(a) redeem the property by tendering fulfilment of all obligations secured by the property, or

(b) reinstate the security agreement by paying the sums actually in arrear, exclusive of the operation of any acceleration clause, or by curing any other default by reason whereof the secured party has become entitled to dispose of the property,

together with a sum equal to the reasonable expenses incurred for holding, repairing, processing, preparing the property for disposition and in arranging for its disposition, and, to the extent provided for in the security agreement, the reasonable legal expenses.

DEBTOR'S RIGHT TO APPROACH COURT WHEN THE SECURED PARTY IS IN POSSESSION

2.7.21 Where a secured party in possession of the property is not complying with his obligations, the debtor or any other person who is the owner of the property or the creditors of either of them or any person who has an interest in the property, may apply to the court, and the court may, upon hearing such application, direct the secured party to comply with his obligations. In the event of any loss arising consequent on the secured party not complying with his obligations in proceeding against the secured property, he shall be liable for loss or damage that may be caused by such failure.

INFORMATION BY THE SECURED PARTY

2.7.22 The debtor should be entitled to require from the secured party the particulars of his indebtedness. In order that banks and other financing institutions are not put to unnecessary expense on this account, such information shall be furnished at the cost of the debtor.

WAIVER BY DEBTOR OF SECURED PARTY'S OBLIGATIONS

2.7.23 It is necessary to recognise certain essential rights in favour of the debtor, which should be available to him even if the security agreement provides to the contrary. Such essential rights shall relate to—

(i) the provisions requiring the secured party to account for the surplus proceeds of the secured property if he disposes of the same;

(ii) the provisions providing the requirements to be complied with by the secured party in the disposition of the property ;

(iii) the provisions dealing with the secured party's liability for his failure to comply with his obligations ; and

(iv) the provisions dealing with the information to be furnished by the secured party about the indebtedness of the debtor.

PROPERTY EXEMPT FROM ATTACHMENT

2.7.24 The secured party's rights to proceed against the secured property shall not extend to the whole or any portion of the property in the possession of the debtor which would otherwise be exempt from attachment under the provisions of the Code of Civil Procedure, 1908.

PART III

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS


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SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

In this Part we set out the summary of the conclusions in the light of our review of our personal property security law. Our recommendations based on such findings are also given here. The recommendations, so far as they relate to suggestions for appropriate provisions in the statutory framework to govern transactions secured against personal property, are already incorporated in the text of the draft Bill which is given in the next Part of this Report. But such recommendations (i.e., those covered by the provisions suggested in the draft Bill) will help in the Government applying its mind to the several features of the draft Bill and taking a decision thereon.

As a preface to the summary of conclusions and recommendations, we may also mention that the conclusions aim to set out the ambiguities and defects we have noticed with reference to the extension of credit by banks, public financing institutions, hire-purchase financiers and other types of lending agencies against the different forms of personal property, such as stock in trade, accounts receivables, fixtures, current crops, motor vehicles and documents of title to goods, under different forms of security devices, such as hypothecation, mortgage, floating charge, pledge, trust receipt, hire-purchase credit. The recommendations, including those that are incorporated in the provisions of the suggested draft Bill, may be viewed in the light of such difficulties and the need for our personal property security law to be shaped to the socio-economic requirements of our country.

GENERAL

(1) Our credit-security law has become antiquated since it does not recognise the functional role of the security but lays undue emphasis on the form, and ignores the substance, of the transaction. It has to be made rational and modern to facilitate intelligent financial planning. In the context of the developmental role banks and other public financing institutions are required to play for implementing the socio-economic reforms and for catalysing economic development, the necessity in our country for a rational scheme of legislation has become urgent. When the security-oriented approach is being discarded by banks and other public financing institutions and availability of credit is determined in accordance with credit planning to suit our national priorities and purposes, our law requires to

be reshaped with a view to reflect the substance of the arrangements and to give such incentives as a legal framework possibly could for the implementation of the national priorities.

[1.1.27]

THE PRESENT STATE OF OUR PERSONAL PROPERTY SECURITY LAW

(2) Now there is no statutory scheme stating clearly the rights of banks and their customers borrowing against personal property. There are no adequate provisions for ascertaining and reconciling the claims of third parties dealing with the secured asset with or without notice of the bank's claim. Ambiguity in personal property security law adds to the cost of credit and also affects the spread and operational efficiency of banks and other financing institutions. This results in the banks' insistence on *other* security like land, buildings, third party guarantee, etc. It curbs banks in taking to innovative credit schemes and in catering effectively to the credit needs of the non-corporate sector, particularly, the weaker sections, small entrepreneurs and small businessmen who are not in a position to offer as security immovable property or third party guarantee.

[1.2.2, 1.2.3 and 1.4.6]

NECESSITY FOR A NEW STATUTORY SCHEME

(3) In order to quicken the pace of the implementation of the new economic programme of the Government aimed to maximise employment and yield optimum socio-economic benefits, there is necessity for a statutory scheme of legislation which will take care of all the existing defects in our personal property security law. The scheme should facilitate—

(i) banks and other financing institutions lending for productive purposes to small businessmen and to other priority sectors under our credit policy,

(ii) the shift, aimed by Government, from capital-intensive to decentralised employment-oriented technologies, and

(iii) reduction in the cost of credit.

[1.2.4 and 1.4.4]

THE PRESENT MAJOR HANDICAPS

(4) The absence of a statutory scheme which would help to decide rationally and readily the rights of parties to a secured transaction, the undue emphasis on the form of the transaction rather than on its substance in deciding the rights of parties, the inadequate machinery for registration of charges over moveables and most essentially

the failure of our credit-security law to recognise and encourage, as in certain developed countries., credit for productive purposes, are the major handicaps in the way of banks and other financing institutions making faster strides than they are now in a position to do, in the fulfilment of the country's socio-economic objectives.

[1.2.5]

COMMON LAW INADEQUACIES

(5) Many of the defects, which we notice in the realm of our personal property security law, are not peculiar to our country alone and they are common to the countries which have adopted by and large the principles of Common Law. Despite the Common Law remedies available to the banks and other financial institutions for securing their interests against those who avail themselves of institutional credit, there is a consensus among the institutions concerned that the existing state of the law does not promote the effective utilisation of personal property as security for credit.

[1.2.6, 1.2.7, 1.4.2 and 1.4.5]

PLEDGE-MORTGAGE DISTINCTION

(6) Courts have never devised a workable rule for making the distinction between pledge and mortgage on which so many important issues turn. The whole matter floats nebulously in the fog, "the intent of the parties", out of which courts are so apt to evoke what they most want. If secret pledge arrangements, under which custody or control over the goods is left with the pledgor, are upheld, the banks may come to grief.

[1.2.13 and 1.2.17]

MORTGAGE *VS.* HYPOTHECATION

(7) When a non-possessory security interest is obtained with reference to chattels or goods, the further question as to whether the security interest is in the nature of mortgage or hypothecation is a purely technical one, and this should not affect the rights of parties.

[1.2.18]

SPECIAL PROPERTY AND INTEREST IN PROPERTY

(8) Decisions on the rights of parties should not be allowed to be clouded by the question as to whether or not on a construction of a document, in the interpretation of which views may differ, only a special property in the chattels has been given, or an interest in the property has been transferred, to the secured party.

[1.2.20]

FIXTURE FINANCING

(9) There is necessity for our credit-security law facilitating fixture financing to further economic development. It is now difficult to reconcile the claims of an institution which has lent against machinery before it is attached or embedded to land, with those of one claiming an interest in such machinery as part of the real property. Again, it is difficult to answer the question as to whether on goods like machinery which has become a fixture we could create a security interest without reference to the land or building to which it is attached. Any answer is liable to be upset by the subjective assessment of courts as to the nature of attachment, intention of parties, *etc.* The reconciliation of the rights of the commercial bank *vis-a-vis* the term-lending institution has to be with reference to the economic function of their credit. This question should not be allowed to be clouded by technical and legal doctrines evolved at a time when fixture financing had not developed. There should be provision in our country for the registration of a charge on a fixture so as to notify persons dealing with the asset. It is also necessary to have equitable rules while enforcing charges against fixtures in order that the claims of those having interests in the immovable property are duly protected.

[1.2.21, 1.2.22, 1.2.29, 1.4.88 and 2.3.3]

'ACCESSIONS' TO MACHINERY

(10) In our country, parts of a machinery are not now charged to any lending institution independent of the machinery. *e.g.*, the engine of a car. But it would be conducive to our economic development if our law could facilitate situations where a valuable part of a machinery is required and this could be obtained on credit from 'A' against a security interest in the part so acquired when the machinery itself is subject to a security interest in favour of 'B'.

[1.2.32 and 1.4.89]

HYPOTHECATION

(11) Since the concept of bankers' hypothecation is not clear, it does not help in understanding the real nature of the secured transaction. There is necessity for a scheme of registration of the security interests arising under hypothecation agreements, since such interests are enforceable now only against those having express or constructive notice thereof.

[1.2.36 and 1.2.41]

HYPOTHECATION IN THE GARB OF PLEDGE

(12) When a hypothecation or a really non-possessory security interest takes the garb of a pledge, the results are inequitable. This highlights the necessity for the law emphasising the substance and not merely the form of the transactions.

[1.2.42]

INSTALMENT CREDIT

(13) Another defect of our credit-security law is its failure to discriminate on substantial grounds to the extent necessary. Thus, the effect of a bank advancing against hypothecation of a motor vehicle and that of a hire-purchase financier extending credit by entering into a hire-purchase agreement with an option clause are now different, though in substance both the transactions are identical. When credit for purchase money is given by banks and hire-purchase financing institutions, the economic function they perform is the same. The law relating to instalment credit, or, in other words, credit for purchase money, has not developed in our country in any rational way due to certain historical reasons.

[1.2.44, 1.2.48 and 1.2.49]

INSTALMENT CREDIT FOR PURCHASE MONEY

(14) With reference to the enforcement of the charge, we have to ensure that the rights and privileges available to banks and other public financing institutions are not in any way inferior to the rights and privileges given to the other classes of financiers. While extending credit for purchase money, the status of banks should not be inferior to that of hire-purchase financiers who also extend credit for purchase money.

[1.2.51]

CODIFICATION OF HYPOTHECATION LAW

(15) There is the urgent need for codifying the law relating to hypothecation. While codifying this branch of law we have to take care to see that we do not perpetuate the archaic anachronistic concepts having no relevance to the current economic needs of our country.

[1.2.54]

TRUST RECEIPT

(16) In all countries where the trust receipt facilities have been extended by banks, conflicts have arisen between business expectations in respect of the trust receipt device and the legal understanding as regards the true character of the trust receipt document.

[1.2.59]

(17) The trust receipt facility is necessary and may have to be provided by banks and other financing institutions to promote exports and facilitate imports. The release of documents against trust receipt in an import situation is traditional and needs no special mention. In relation to a packing credit advance, it will highly benefit export promotion. As in the U.S.A., it has great potential also for financing internal trade and commerce.

[1.2.93]

(18) On grounds of public policy, the status of perfected security interest (that is, as if the security interest in favour of a bank is registered) may be conferred on trust receipt advances for a short period without the need for any registration, as has been provided for by legislation in the U.S.A., Canada, *etc.* By conferring this facility only on banks and approved financing institutions and thereby insulating against fraudulent action and by providing for registration were the facility to continue beyond any specified limited duration, we could effectively take care of trust receipt advances and also make them available to small merchants and traders.

[1.2.94]

(19) In an era where banks and other financing institutions are shifting from a security-oriented approach to purpose-oriented lending, to fulfil certain broad socio-economic objectives to implement a radical economic programme which has as its main thrust benefiting small and weaker sections of the society, there is imperative need for legislation to cover trust receipts and other equitable charges. Codification of the law relating to trust receipts is necessary to enable banks to play more effectively their role as catalysts of economic development.

[1.2.93 and 1.2.95]

PERSONAL PROPERTY SECURITY LAW—TO BE CODIFIED

(20) In view of the chaotic state of our personal property security law, it is necessary to codify this branch of the law. This would also implement the recommendations of the Banking Commission and of

its Study Group which reviewed legislation affecting banking. It is in these circumstances that a new codifying and reforming statute has become necessary to regulate transactions secured against personal property. The analysis of the present position in our country with reference to security interests obtained in transactions secured by personal property under the different forms of security devices now in vogue, like mortgage and pledge of moveables, hypothecation obtained by banks, hypothecation or mortgage over fixtures, trust receipt advances *etc.*, clearly points to the necessity for a fundamental re-orientation with reference to Common Law concepts now governing transactions secured by personal property. While codifying our personal property security law having regard to the special socio-economic requirements of our country, we should also benefit from the reforms effected in other countries.

[1.2.97 and 1.2.98]

NEED TO DISTINGUISH CONSUMER CREDIT FROM BUSINESS CREDIT

(21) Credit for purchase money merits special recognition owing to its significant role in the economic development of our country. But, considerations relevant to the granting of *consumer credit* for enabling consumers to acquire consumer durables on instalment basis are not necessarily valid while considering the grant of *instalment credit for genuine business requirements.* The hire-purchase financing institutions, which are now the major purveyors of instalment credit, grant instalment credit by entering into what they call "hire-purchase agreements". The major component of such credit given by hire-purchase financing institutions goes to the road transport industry. In so far as instalment credit is given for meeting the needs of the industry, the necessity for consumer protection does not as such arise except the necessity to see that by reason of the artificial and allegorical language used by the hire-purchase financing institutions in granting this form of credit small business people are not affected.

[1.3.1, 1.3.2, 1.3.7 and 1.4.86]

ALL INSTALMENT BUSINESS CREDIT UNDER ONE SCHEME

(22) Both on logic and with a view to ensure that credit for productive purpose is not hampered by unnecessary legal constraints, it becomes necessary to deal comprehensively with the law governing instalment credit for meeting the needs of industry, trade and commerce, whether such credit is given by banks or by hire-purchase financing institutions. The archaic nature of our credit-security law becomes obvious when we find that while the law ignores the valid distinction based on the purpose of the instalment credit for purchase

money, because of its undue reliance on the form of the credit it has allowed an artificial and invidious distinction which operates to the prejudice of commercial and co-operative banks and development financing institutions like the State Financial Corporations *vis-a-vis* hire-purchase financing institutions. The fact whether the form of instalment credit is termed as "hypothecation" or is termed as "hire-purchase", should not be relevant to decide the rights of parties.

[1.3.4, 1.3.9, 1.3.12 and 1.4.7]

HIRE-PURCHASE AGREEMENT—ITS TRUE CHARACTER

(23) Now in several countries of the Commonwealth including the U.K., Canada and Australia, hire-purchase agreement is viewed as a form of secured transaction. Adoption of such an approach is also necessary in India. In all recent reviews in the countries of the Commonwealth, stress has been laid on the law being structured on a functional basis and the necessity for dispensing with the dichotomy of vendor's credit and lender's credit and to look at hire-purchase transaction as a form of instalment credit. Recent legislation in developed countries has given effect to this functional approach.

[1.3.12, 1.3.13, 1.3.29 and 1.3.30]

(24) The validity, in real terms, of the concept of "owner" and "hirer" employed in hire-purchase business and the point of distinction now made in our country as to when a hire-purchase transaction is really a secured transaction and when it is not has hardly any substance.

[1.3.35]

(25) Partially, without the need for legislation, our courts have been able to decide about hire-purchase transactions by looking at the substance of the hire-purchase agreement by piercing the allegoric veil in which the terms of the contract are expressed. Though the veil is pierced and is in tatters, it still remains, that is, with reference to hire-purchase agreements where the hirer is said to have an option. This tottering and torn veil would naturally fall once the law recognises the fact that the option to the hirer is never contemplated to be exercised by the hirer-borrower at the time he entered into the hire-purchase agreement.

[1.3.43]

STATUS OF HIRE-PURCHASE FINANCIER

(26) If hire-purchase finance companies are regarded only as financing institutions, the anomaly is readily perceived in regarding them as sellers of goods under the hire-purchase agreement and thereby engaged in trading—whether there is an option clause or not in the hire-purchase agreements.

[1.3.57]

INSTALMENT CREDIT BY BANKS IN "HYPOTHECATION" FORM

(27) The viewing of instalment credit given on hire-purchase terms, having regard to the substance of the arrangement, that is, as a secured transaction, effectively removes the legal impediments in the way of banks providing instalment credit directly. Unless the legal impediments are eliminated, banks will be handicapped from developing the expertise necessary for providing instalment credit directly, since the "hypothecation" form they have recourse to does not adequately safeguard their interests.

[1.3.55]

INSTALMENT SALE *VS.* INSTALMENT CREDIT

(28) The theory of instalment sale is now recognised in our country only where the hire-purchase agreement provides an option to the hirer to repudiate the purchase, that is, the type of transactions considered by the Supreme Court in Johar's case. Viewing hire-purchase transaction as an instalment sale artificially colours the transaction. The development of the hire-purchase form was peculiar to the circumstances that prevailed in the U.K. It has no direct application to our country. Even in the U.K., the Crowther Committee has recommended that the legal notion of instalment sale should disappear. There is similar recognition in other countries of the Commonwealth where hire-purchase form of financing is in vogue. In view of the need to rationalise our legal infrastructure, we should dispense with the notion of instalment sale (which is in anti-thesis to the theory of "instalment credit"). In the field of hire-purchase financing, there are also other substantial and positive advantages which accrue, on such rationalisation, by the elimination of the following drawbacks:

(a) Adherence to the theory of instalment sale unnecessarily adds to the cost of credit flowing through financing agencies by necessitating a three-tier system for providing instalment credit even in areas where we do not have competent and well-managed hire-purchase financing institutions;

(b) Adherence to instalment sale concept in the field of hire-purchase adds to the various difficulties experienced by banks and referred to by the Study Group on Non-Banking Financial Intermediaries set up by the Banking Commission ;

(c) Instalment sale concept comes in the way of banks effectively becoming prime lending agencies for instalment credit even in areas or in fields where banks possess the necessary expertise;

(d) While the theory of instalment sale affects banks from effectively becoming prime providers of instalment credit, it distorts the true role of a non-banking financial intermediary, like a hire-purchase financing institution, by depicting the same as a trading concern;

(e) Instalment sale concept affects the ability of the industries availing themselves of instalment credit from getting the full benefit of the fiscal concessions, like development rebate, depreciation allowance, *etc.*, that may be extended by Government;

(f) Instalment sale concept affects the ability of a small borrower or a hirer-businessman to find working capital for running the machinery or the vehicle acquired by him on instalment credit ;

(g) Instalment sale theory perpetuates the right of "snatch-back" by the "owner" though protective legislation may try to restrict the unfettered exercise of this right ;

(h) Instalment sale concept subordinates the security interest of banks, which provide instalment credit, to even the interest created by an unregistered hire-purchase agreement, and it affects the ability of banks to take possession of the security without recourse to court ; and

(i) Instalment sale concept deprives banks from claiming a preferential security interest for purchase money where the banks finance the acquisition of goods.

[1.3.79]

BANKS' DIFFICULTIES RE. INSTALMENT SALE CONCEPT

(29) The necessity for covering under one scheme the major groups which purvey instalment credit is clear when we find the difficulties experienced by banks in giving instalment credit concurrently with the pervalence of the concept of instalment sale. The facts and

the decision in Manasuba's case bring to the foreground the conflicts underlying the simultaneous application of the ratio of the decisions of the Supreme Court in Johar's case and Sundaram Finance case.

[2.2.7]

(30) The institutionalisation of hire-purchase credit and encouragement for the formation and growth of strong and viable units could be effectively ensured only when the framework of our credit-security law allows ample scope both for banks and the hire-purchase financing institutions to play their proper role in dispensing purpose-oriented instalment credit for purchase money.

[2.2.14]

(31) In areas where well-managed and efficient hire-purchase finance companies are not functioning or where it is necessary to supplement the credit provided by or through such institutions, banks and other financing institutions may have to fill the gap. This would be facilitated by dispensing with the concept of instalment sale.

[2.2.16]

(32) It is true that under the provisions of the Motor Vehicles Act, 1939, as they stand now, in the certificate of registration of a motor vehicle both a hire-purchase financier and a hypothecatee-bank may have their interests noted. This by itself is not adequate to protect the security interest of a bank *vis-a-vis* the claims of a hire-purchase financier.

[2.2.19]

HIRE-PURCHASE FINANCING COMPANIES AND THEIR REGULATION

(33) Hire-purchase companies classified as non-banking financial companies are strictly banking institutions as defined in the Banking Regulation Act, 1949, though a milder form of banking regulation is applied to them now pursuant to the Directives issued by the Reserve Bank of India under Chapter III-B of the Reserve Bank of India Act, 1934. *Underlying this exposition is implicit that the application of moneylending legislation to them is entirely inappropriate.*

[2.2.30]

(34) In view of the definition of "banking" found in our Banking Regulation Act, 1949, it is obvious that hire-purchase finance companies, which accept deposits from the public for lending (under instalment credit or instalment sale basis) and thus are a class of banking institutions, have continued to stay away from the operation of

the moneylending legislation and this position will continue. However, it is appropriate that the form of regulation now applied to this class of banking institutions is brought as part of a comprehensive scheme of banking regulation. Such a form of regulation has already been recommended by the Banking Commission. Government may like to consider making in due course appropriate changes to the Banking Regulation Act, 1949, so that a class of banking institutions which are now regulated as non-banking institutions may be regulated hereafter having regard to their true status, namely, as a class of banking institutions.

[2.2.32]

(35) There may be a case for the Centre to review the extent of regulation as regards acceptance of deposits from the public by firms and proprietary concerns. If, in public interest and to subserve the common good, the law relating to acceptance of deposits from the public prohibits firms and proprietary concerns from having recourse to deposit-taking function, it would only be a necessary incident of the Union's right to regulate the business of banking in accordance with such objectives.

[2.2.35]

(36) Since instalment credit by hire-purchase finance companies to the transport industry is considered necessary to be encouraged, financial institutions providing instalment credit, whether in the form of hire-purchase agreement or otherwise, in relation to motor vehicles, which accept deposits from the public and which are notified by the Central Government in this behalf, should also be eligible to the priorities and privileges available to banks in general under the scheme of the personal property security law.

[2.2.37]

(37) The special and preferential position of hire-purchase finance companies under the Reserve Bank's Directives is not based on the colour or the form of the security device adopted by such companies but on the fact that they provide essential instalment credit to the road transport industry.

[2.2.38]

(38) In section 45I of the Reserve Bank of India Act, 1934, the relevant portion of the definition of "financial institutions" has been altered in 1974 to refer to institutions entering into hire-purchase agreements as defined in the Hire-Purchase Act, 1972. This is a restrictive view of hire-purchase agreements; this covers only those agreements with option clause. How this link with the option clause

perpetuates the instalment sale concept and brings in anachronistic and undesirable results have been summed up by us in paragraph 1.3.79. By dispensing with the archaic and anachronistic notion of instalment sale, we are only making clear the functional role of the hire-purchase finance companies. In order to avoid a legally restrictive view and to make the position abundantly clear, we are recommending an amendment (in the draft Bill) to section 45I of the Reserve Bank of India Act, 1934, so that the section would cover *inter alia* all "non-banking institutions" providing instalment credit for purposes that may be approved by the Reserve Bank.

[2.2.40]

HIRE-PURCHASE AGREEMENT AND SALES TAX LAW

(39) Where in substance an agreement is only a secured transaction, there is also no legality or justification for considering it as a sale for the purpose of Sales Tax legislation.

[2.2.41]

REVIEW OF HIRE-PURCHASE ACT

(40) We concur with the recommendations of the earlier two expert bodies, namely (i) the Study Group which reviewed legislation affecting banking and (ii) the Banking Commission, with reference to the Hire-Purchase Act, 1972. The fact that before the Banking Commission's recommendations could be considered the Hire-Purchase Bill, 1968, was passed by Parliament does not materially affect the position. On the contrary, the non-enforcement of the legislation so far is a positive factor which enables Government now to look at the whole spectrum of our credit-security law in its broad perspective and come forward with reformative legislative measures.

[2.2.11]

SECOND-HAND VEHICLES UNDER THE HIRE-PURCHASE SCHEME

(41) As regards second-hand vehicles, the question of the hirer exercising an option not to purchase the vehicle is of much less significance and is of no meaning. Again, with reference to second-hand vehicles the difficulty of finding out the cash price has been experienced and this is another factor coming in the way of the application of the hire-purchase scheme with reference to second-hand vehicles. These difficulties will not survive when instalment sale concept is not applied. It is necessary that instalment credit financing against second-hand vehicles should also be encouraged.

[2.2.17 and 2.2.18]

HIRE PURCHASE ACT AS A CONSUMER CREDIT LEGISLATION

(42) Once we bring under one scheme of personal property security law all forms of security devices including provision of instalment credit for purchase money in the form of hire-purchase, then on a review of the hire-purchase legislation the necessity for amplifying or amending suitably any provision for protecting the interests of consumers in addition to those which may be available under the general scheme may have necessarily to be gone into. But this will not affect the security aspect of instalment credit transactions for purchase money, particularly instalment credit for business and commercial requirements.

[2.2.22]

VALUE OF SECURITY

(43) Legal security serves the purpose of requiring both the lender and the borrower to make a serious evaluation of the risks involved. In this way the taking of security injects a sense of discipline and responsibility into the activities of both of them. Furthermore, security affords the lender an opportunity to refinance loan portfolios in order to increase liquidity. It is insurance against the possibility of changed circumstances falsifying the predictions of the feasibility study.

[1.4.17]

(44) The legal structure should recognise the functional and beneficial uses of security. Under a scheme with such objectives, the function of the law is to provide a system whereby it is possible to engage in intelligent financial planning taking into account both the private profitability of the enterprise and the public responsibility of the developer. In particular it must allow the assets of the enterprise to be simply, inexpensively, efficiently, and comprehensively mobilised as security for the finance that is required.

[1.4.18]

FORMS OF SECURITY LINKED WITH PURPOSE OF CREDIT

(45) In deciding between the different types of security, each security must be considered in the light of the purpose for which it was created. Thus, the purpose of a credit for purchase money is to enable the borrower to acquire the machinery or the motor vehicle which is to form the prime security. The purpose of credit against the hypothecation of crops is to enable the farmer to raise current crops. Likewise, in bank lending the different forms of security are generally related to the purpose for which credit is given.

[1.4.19]

(46) The fact that a borrower is in a position to offer security not connected with such purpose of credit may not help in security playing its functional role. It should not be the policy of law to encourage the obtaining of such independent security which is unrelated to the purpose of the credit, though recourse to additional security may be permissible and feasible in special circumstances.

[1.4.20]

FORMALITIES AND REGISTRATION

(47) The formalities relating to the creation of the security should in all cases be as simple and as cheap as possible, but should provide a permanent record of the transaction.

[1.4.22]

(48) Registration of the security should be essential as a form of public notification for the perfection of the security, except where public notification is adequately provided for by other means. This, for example, is to be found when the creditor takes possession of the security to the exclusion of the debtor.

[1.4.23]

(49) Any system of registration should, however, be simple and inexpensive and, in particular, should not require registration of all credit and security documents. All that third parties concerned with the borrower's title to the security need to know is that the title is encumbered, and the address of the lender from whom they can obtain further information. What should be registered therefore is not documents but the fact that the security interest arises from the documents. This can be achieved by a system of notice filing.

[1.4.24]

(50) Questions of priority of claims against the security should depend entirely on the time of perfection, that is, the time of registration or of taking possession. Priority should not be made to depend on questions of title to the security, nor on questions of notice, nor on artificial and non-functional distinctions based on the character of the borrower, nor on distinctions between law and equity, nor on distinctions based on the formalities needed to create the security.

[1.4.25]

DISCRIMINATION NECESSARY BETWEEN PUBLIC FINANCING INSTITUTIONS AND MONEYLENDERS

(51) There are basic differences in credit appraisal by moneylenders and by banks and allied financing institutions. Our credit-security law would serve better the needs of commerce, industry and trade and

would catalyse development if it could recognise this special role of banks. For example, special recognition may have to be given to banks extending credit against trust receipts. Again, in the matter of perfection of security interests, in deciding about priority rules and in realising the security, the law may validly distinguish between banks and other public financing institutions, and private moneylenders.

[1.4.26]

STATUTORY FRAMEWORK SHOULD BE COMPREHENSIVE

(52) Since the area where changes are required covers almost the entire field of personal property security law, it is obvious that a comprehensive restructuring of the legal framework relating to our personal property security law is necessary.

[1.4.29]

(53) The attempt to have a hypothecation law, a pledge law, a trust receipt law, an instalment credit law and a law relating to fixtures, each to have its own scheme, is not only an unnecessary exercise but will create several other problems and new technicalities. Such a step would run counter to the underlying theme of a rational analysis of the necessity for security and its functional use. It is in the interest of credit planning that the security law and the security devices reflect the substance of the arrangement and do not distort the picture by reason of the inappropriate form that may be adopted, having regard to the economic function of the security.

[1.4.34 and 1.4.35]

VALUE OF NEUTRAL TERMINOLOGY

(54) The law now does not reflect, nor does it give any indication of, the purpose for which a credit is allowed. When we adopt neutral terms appropriate to all forms of security, without undue emphasis on the form of the secured transaction, purpose-wise analysis and purpose-wise utilisation of credit are facilitated. If credit-security law could employ terms which would give an indication of the purpose for which credit has been given, *e.g.*, "security interest for purchase money", "non-purchase money security interest", "current crop loan security", "security interest over fixture", "security interest over inventory", "security interest over documents of title to goods", *etc.*, instead of engulfing all such advances under one classification, *viz.*, "hypothecation advance", obviously the law will facilitate purpose-wise analysis of the credit. This, and the priority rules based on the purpose of the credit, will also facilitate the

purpose-wise utilisation of credit. The adoption of neutral terms also contributes to the development of our credit-security law without the constraints of archaic property concepts.

[1.4.36]

(55) New terminology is also important as a means of avoiding the use of existing terms of art carrying with them meanings and interpretations resulting from previous decided cases. For a modern personal property security law it is essential that it should be able to cut free from words that have acquired over the years a distinctive significance which might well run counter to the underlying principles and policies of the proposed new legislation.

[1.4.37]

(56) In the new statutory scheme which should govern secured transactions, there is the need for reconciling the different questions as to priority, creation and enforcement of charge and other allied matters without going into technicalities as to whether or not under the security agreement an interest in the property passes, whether the transaction creates a special property or an interest in the property, *etc.* The new scheme of personal property security law developed in other Common Law countries have successfully avoided such complicated questions by adopting a neutral terminology.

[1.4.46]

(57) Hence, on policy objectives, for furthering credit planning in our country and for the implementation of the new economic programme of the Government, it is necessary that the terminology that we adopt in our credit-security law is neutral so that it would not colour the real nature of the transaction from being readily perceived. Adoption of neutral terminology helps the determination of questions as to preferences and priorities based on the substance of the transaction.

[1.4.49]

(58) Suggestions that a statutory scheme to regulate transactions secured against personal property should continue to employ terms like hypothecation, pledge, mortgage of moveables, *etc.*, will defeat the very object of giving security a functional role in our credit-security law. The recourse to neutral terminology is necessary in public interest. Bankers and lawyers are not unskilled craftsmen. In tune with the necessities for change, they have remarkably assimilated and applied innovative techniques and new schemes for granting and disbursing credit. Even under the existing legal framework, with all its constraints, they have applied a lot of innovations and modern

techniques to effectively subserve the needs of economic development and promote growth. Hence, it is but natural to expect that the new concepts and the new terminology which are required to be employed will also be assimilated and applied by the bankers and banks' lawyers and their clientele with expedition since the new terminology is being brought in only to expedite the handling of credit transactions and reduce, to the extent possible by legal reform, the time, labour and cost involved in the granting of credit.

[1.4.52]

BROAD BASIS OF THE NEW SCHEME

(59) A statutory scheme like that of Article 9 of the Uniform Commercial Code of the U.S.A. is necessary in our country. But it is obvious that the scheme has to be oriented to suit the social and economic milieu of our country and subserve the economic and credit policy objectives of our country. The new statutory scheme should simplify and rationalise our credit-security law. The scheme has to highlight national priorities and facilitate the flow of credit in desired channels. This requires that while we may benefit from the Article 9 scheme and the comparable legislation, we have to evolve our own scheme.

[1.4.66 and 1.4.67]

SECURITY AGREEMENTS

(60) Any agreement which in substance creates a security interest in moveable assets (including fixtures irrespective of whether the fixtures are regarded as moveables or not) should come within the scope of the statutory scheme. While the existing forms of security agreements, styled hypothecation agreements, *etc.*, may continue to be employed until more precise and clearer forms are drawn up by banks and other lending agencies, the rights of parties in material respects must be decided by the statutory scheme.

[1.4.69]

(61) In order that the borrowers of banks and others may be aware that such a security agreement is to take effect only as provided in the statutory scheme, banks and other public financing institutions may be asked to stamp the security agreement form with the following legend:

> "This agreement will take effect subject to the provisions of the Personal Property Security Act, 197 ."

[1.4.70]

LEASES AND ASSIGNMENTS AS SECURED TRANSACTIONS

(62) The scheme of our credit-security law should also cover the leasing of property (moveables and fixtures) intended to act as security. Since book debts and other actionable claims obtained as security may take the form of assignment, the scheme should cover also assignment of actionable claims and such other rights to intangibles. However, assignment for the general benefit of creditors may have to be excluded from the scope of the scheme.

[1.4.71]

ATTACHMENT OF SECURITY INTEREST

(63) For the security agreement to take effect (technically it may be called, "to attach"), the main criteria should be the time when the debtor gets rights in the property offered as security and the presence of consideration. Ordinarily, as between the secured lender and the debtor, the terms of the agreement should be enforceable. But third persons' claims on the security should be subordinated only when they have actual or constructive notice of the security interest claimed under the security agreement.

[1.4.72]

PERFECTED SECURITY INTERESTS

(64) A security interest claimed under a security agreement (by whatever name called) and covering goods in the possession of the secured party or in respect of which registration in the manner provided has been effected, should be regarded as a perfected security interest. Such a perfected status should also accrue to a security interest covered by a trust receipt advance granted by a bank, and to an advance against a document of title to goods deposited with the secured party.

[1.4.73]

(65) While the general rule should be that a perfected security interest should prevail over the claims of third persons for an interest in the goods offered as security, there may have to be valid exceptions to cover cases, like the buyer of goods in the ordinary course of business purchasing from a retailer whose inventory is covered by the security agreement. Such exceptions are not many and could be taken care of in the statutory scheme.

[1.4.74]

REGISTRATION OF SECURITY INTEREST

(66) There is paramount necessity for a simple, inexpensive and easily accessible registration machinery. At the same time, having regard to our technological development, it may not be feasible to go

in straightaway for a computerised scheme for registration of security interests in personal property. For the development of an adequate registration machinery, we may have to plan our requirements in two stages.

[1.4.75]

(67) While, as a long-term perspective, we may examine carefully a computerised registration system providing for central and notice filing of security interests, the registration of security interests in personal property cannot be made to wait for the evolution of such a computerised scheme. Hence, the available apparatus for registration of security interests over the assets of different classes of debtors will have to be put to maximum use as immediately as practicable in order that our credit-security law which recognises the functional and economic role of security can be brought into force with expedition. Hence, *immediate attention need be focussed only on the development of a registration machinery from the administrative and legal set-up now available.*

[1.4.76]

REGISTRATION OF CHARGES UNDER COMPANY LAW

(68) At present, administrative and legal set-up exists for registration of charges over the assets of companies. With appropriate modifications, this set-up should be put to optimum use to support our credit-security law.

[1.4.77]

RE. FIRMS AND PROPRIETARY CONCERNS

(69) There is the urgency for developing an administrative and legal set-up to provide for registration of security interests over the assets of firms and proprietary concerns.

[1.4.78]

SPECIAL PROVISIONS RE. BANKS

(70) In order that the work on account of the registration of security interests over moveables and fixtures of firms and proprietary concerns does not lead to insurmountable pressures in the office of the Registrar of Assurances, it is necessary to specify:—

(a) for banks and other financing institutions filing with the Sub-Registrars, that notification containing particulars of their security interests may be sent through registered post;

(b) that even without such notification, banks and other financing institutions could enforce their security interests as perfected security interests (in other words, want of such a notification by banks and other financing institutions should not affect the enforceability of the security interest though it may affect their priority); and

(c) that the place where the firm or proprietary concern carries on business (or where it has the Income-tax Permanent Account Number) shall be the appropriate place for registration of security interest in personal property other than a fixture or crops.

[1.4.81]

REGISTRATION OF FIXTURE CHARGE

(71) Though for the creation of the security interests and for the determination of rights and priorities a fixture should be regarded as a movable property under our credit-security law, yet we should provide that it should be so registrable with the Registrar of Assurances in a separate register which he may maintain for this purpose and wherein particulars relating to the land or the building in which the fixture is installed or annexed will also be noted and made available for registration. Registration should merely mean notice filing and the appropriate place for registration should be the place where registration is required to be made of an interest in the land to which the fixture is, or is to be, attached. The register should be available for inspection by the public.

[1.4.82]

REGISTRATION RE. MOTOR VEHICLES

(72) Since both banks and hire-purchase financiers are providing instalment credit for purchase money for the acquisition of motor vehicles, both their interests would require mention in the certificate of registration, and the existing discrimination which operates to the prejudice of banks in the matter of their rights over the vehicle should be eliminated. [1.4.83]

EFFECT OF FAILURE TO REGISTER

(73) Want of registration should not affect the validity of the security interest. It may affect priorities and may be a legitimate factor to be considered where the genuineness of the agreement is in question. Subject to this, the law should recognise both unperfected and perfected security interests. As a general rule, in the case of perfected security interests priority should be determined by the order

of registration or perfection. The date of attachment of the security interest should be relevant for determining priority only when there is no conflicting perfected security interest. [1.4.84]

PROTECTION TO BANKS RE. CHARGE OVER A FIRM'S ASSETS

(74) Where a security interest is claimed over the assets of a firm or a proprietary concern, a bank's claim should be protected over the claim of any unsecured creditor including the claim for Government dues. Such protection should also be available in the event of insolvency. These provisions are necessary to place on proper and sound basis the advances by banks and other public financing institutions to firms and proprietary concerns. As regards fixtures, motor vehicles or crops, there is no necessity for such special treatment. [1.4.85]

DOCUMENTS COVERING FUNGIBLE GOODS

(75) Warehousing business would develop and agricultural sector would benefit considerably were our law to provide for bulk warehousing and documents being issued regarding fungible portion of commingled goods. The current crops produced in a village can be bulk-stored and the cultivators can be issued documents of title by the warehousemen; these documents need not cover earmarked bags but may indicate the quantity stored by the particular individual and comprised in the total warehoused bulk. The necessity for developing our warehousing facilities has been stressed by several bodies and the provision providing for reconciliation of the rights with reference to the commingled goods which may be bulk-warehoused and which may be covered by the issue of documents of title covering fungible goods has special merit having regard to the rural and agricultural bias of our country. [1.4.90]

RIGHTS AND REMEDIES ON DEFAULT—RE. BANKS' DUES

(76) While on the subject of rights and remedies consequent on default, we have to keep in view two fundamental factors which are of common experience. Realisation of security through judicial process is very expensive and time-consuming. If the funds of banks and other public financing institutions are locked up, other eligible and creditworthy purposes are starved of credit in a period of credit scarcity. Hence, the law should provide for the realisation of dues by banks and other public financing institutions by recourse to the security as far as possible without judicial intervention. [1.4.91]

RE. DUES OF OTHER LENDERS

(77) Where the lending agency is not a bank or other financing institution, there is the possibility of the secured party acting somewhat arbitrarily in enforcing its rights over the security. This possibility is all the more so when such an agency claims an unperfected security interest. Hence, unperfected security interests claimed by persons other than banks and other public financing institutions should be enforced only through judicial process. [1.4.92]

CLASSIFICATION OF PROPERTY

(78) An appropriate classification of property offered as security is necessary for our personal property security law. [1.4.94]

RULES BY CENTRAL GOVERNMENT

(79) The Central Government should be the appropriate agency which could watch the enforcement of the statutory scheme. Hence, the Government should be enabled to frame rules for the proper functioning of the various registration authorities coming within the ambit of the personal property security law. The Government should also be empowered to pass orders and make necessary rules for the removal of any doubts and for resolving any difficulties experienced in the operation of the statutory scheme. [1.4.95]

SPECIAL POSITION RE. INSTALMENT CREDIT RE. MOTOR VEHICLES

(80) Appropriate recognition in our personal property security law regarding instalment credit for purchase money for motor vehicles is required on the following aspects :

(i) purchase money credit against a chassis of a motor vehicle is required in the first instance and additional finance is required for constructing a body thereon — the commercial situation is such that it would be inadvisable and may not be practicable, were two financiers to intervene separately (unless they act as a consortium), one providing credit for the acquisition of the chassis and another giving credit for the construction of the body; and

(ii) the fact that commercial and administrative convenience does not encourage registration at the same time of two or more successive security interests over the same vehicle. [2.2.44]

(81) The scheme of personal property security law should specially provide that a security interest for purchase money which has attached to the chassis of a motor vehicle before the body is built thereon shall

be deemed to be perfected for a period of three months from the date of such attachment, and that during this period the body built thereon shall be an addition to the security notwithstanding the general rules relating to accessions. In exceptional cases where this three month period may not be adequate, recourse may be had to temporary registration of the vehicle as a chassis and noting of the security interest in the temporary certificate of registration. [2.2.47]

(82) If two or more successive security interest claims are to be noted in respect of a motor vehicle, it will be throwing an unduly heavy burden on the borrower as he will have to obtain the consent of all such security interest holders before he could effectively transfer the vehicle. It is likely that the borrower may require finance for meeting the running cost of the vehicle, like replacing the tyres, petrol charges, *etc.* But commercial expediency does not permit giving of any perfected status to such claims; as otherwise, instalment credit financing of motor vehicles would run into unnecessary difficulties. Hence, in line with the principles underlying the present section 31A of the Motor Vehicles Act, 1939, it may have to be provided that at any point of time there could be only one registration of a security interest against a motor vehicle. [2.2.49]

(83) Having regard to the Constitutional position and the merits of the case, it is necessary to amend sub-section (5) of section 31A of the Motor Vehicles Act, 1939, in such a way as to enable the registering authority to issue a fresh certificate of registration (not a duplicate thereof) in favour of the secured party who has noted his security interest in the certificate of registration. [2.2.57]

(84) It is necessary to have a statutory provision to protect secured parties entering into a security agreement regarding a motor vehicle in good faith and for value with a person in whose name the certificate of registration of the motor vehicle stand. It is also necessary to provide that when such a secured party has his security interest recorded in the certificate of registration, no other person claiming an interest in the vehicle shall be entitled to assert his claim in preference to the claim of such secured party. Section 31A of the Motor Vehicles Act, 1939, also requires suitable amendments to provide for registration of security interests consistent with the provisions of the personal property security scheme. [2.2.59]

SECURITY INTEREST FOR PURCHASE MONEY (OTHER THAN MOTOR VEHICLES)

(85) It is necessary to provide that a security interests for purchase money in goods (other than a motor vehicle) remains automatically perfected for a period of ten days from the date the debtor obtains

possession of the property. Such a security interest shall have priority over the interest of any transferee from the debtor claiming under a transfer not in the ordinary course of business of the debtor but effected during this period. It is also necessary to provide on similar lines with reference to any conflicting security interests over the secured property or its proceeds, other than inventory. [2.2.62]

SECURITY INTEREST FOR PURCHASE MONEY IN INVENTORY

(86) Recognition of a preferential position for purchase money security interest in inventory helps considerably the industrial reconstruction of sick units. But a security interest for purchase money in inventory can be given a priority only subject to safeguards which on the one hand will ensure the bona fides of the arrangement and on the other will give reasonable protection to earlier registered security interests in inventory. In order to claim priority over a conflicting security interest in the same inventory, or in identifiable cash proceeds received from such inventory, the purchase money security interest in inventory should satisfy the following conditions:

(1) the security interest for purchase money should be perfected at the time the debtor receives possession of the inventory; and

(2) the person having security interest for purchase money should give notice in writing to the person having the conflicting security interest where the latter had registered his security interest covering the same types of inventory—

  (i) before the date of the registration by the person having security interest for purchase money; and

  (ii) before the beginning of the thirty day period where under trust receipt type of advances the security interest for purchase money is temporarily perfected in favour of a bank; and

  (iii) the holder of the conflicting security interest should receive the notice before the debtor receives possession of the inventory; and

  (iv) the notice should state that the person giving the notice has acquired or expects to acquire a security interest for purchase money in the inventory of the debtor, describing such inventory by item or type. [2.2.63 to 2.2.65]

PURCHASE MONEY CREDIT FOR CROP LOANS

(87) The purchase money priority has to be recognised whether the credit is for a commercial purpose or is extended for an agricultural purpose. It is necessary that in our statutory scheme we should provide a priority for current crop loans by banks. Where a bank gives consideration to enable the agriculturist-borrower to produce current crops, there should be a preference in favour of such credit and the credit should have a first charge on the current crops. Ordinarily, when a bank gives consideration to enable the debtor to produce the crops and that is given not more than three months before the crops become growing crops by planting or otherwise, the bank should have priority over any earlier perfected security interest, even though while giving the consideration the bank knew of the earlier security interest. The Central Government should be authorised to vary by rules the period of three months for the different areas of our country having regard to the nature of the crops, the seasonal and other local conditions. [1.4.87 and 2.2.66 to 2.2.68]

FIXTURE—DEFINITION

(88) A fixture should be defined as goods embedded in the earth or affixed to what are so embedded and shall include—

(a) goods that are severable from a building or land by unscrewing, unbelting, unclamping or uncoupling or by some other method of disconnection, and

(b) machinery installed in a building which is capable of being removed without substantial damage to the building apart from the removal or destruction of the bed or casing on or in which the machinery is set and the making or enlargement of an opening in the walls of the building sufficient for the removal of the machinery.

But the definition shall not include building and building materials. [2.3.4]

RULES RE. FIXTURE

(89) The perfection of a security interest in a fixture has to be by a method which would give notice to the persons dealing with the factory or the land of the existence of a fixture charge in favour of the fixture financier. While the basic concept of fixture as movable assets has to be retained, the machinery now available for registration of land charges should be effectively used under a simplified procedure for recording security interests in fixtures. [2.3.6]

(90) A security interest in a fixture shall be recorded in Book No. 1 referred to in Item A of sub-section (1) of section 51 of the Registration Act, 1908. An application for registration of a security interest in a fixture shall be made in the manner provided by the rules. The rules may provide the manner in which such an application shall be executed, verified and authenticated. The application shall contain a description of the immovable property to or in which the fixture is or is to be affixed or embedded. Under the simplified procedure, an application for registration of a security interest in a fixture, as with reference to other forms of personal property, may be effected by post. [2.3.7]

(91) For reconciling conflicting security interests in a fixture, the following rules as to priority shall be applicable to fixtures:

(1) A security interest that attaches to goods before they become a fixture shall subsist and shall have priority as to the goods over the claims of any person who has an interest in the immovable property, provided the application for registration of such security interest as applicable to a fixture is made within a period of thirty days from the date the goods become a fixture.

(2) The security interest in a fixture arising after the goods became a fixture shall be subordinate to the interest of a creditor with a prior registered encumbrance on the immovable property in respect of any subsequent advance made in accordance with section 79 of the Transfer of Property Act, 1882.

(3) A perfected security interest in a fixture arising after the goods became a fixture shall have priority over the claims of any person who subsequently acquires an interest in the immovable property but not over any person who had a registered interest in the immovable property at the time the security interest attached to the fixture. [2.3.8]

(92) A fixture-charge holder when he has priority over the claims of a person having an interest in the immovable property shall have power to remove the fixture from the immovable property in the event of default by his borrower. However, the fixture-charge holder shall be liable to reimburse any encumbrancer or owner of the immovable property other than the borrower, for the cost of repairing any structural damage that may be caused by the removal of the fixture. A person entitled to such reimbursement may require the fixture-charge holder to furnish adequate security for such reimbursement. A fixture-charge holder, before effecting the removal of the fixture from the immovable property, should also be required to give

a suitable notice to each person in whose favour there exists a registered interest in the immovable property. After giving such notice, he should allow a period of twenty-one days for any such entitled person to pay the amount due in respect of the fixture charge. The court, in appropriate cases, may extend the time for such payment. [2.3.9 and 2.3.10]

RULES RE. ACCESSIONS

(93) "Accession" may be defined as goods that are installed in or affixed to other goods. The priority rules that may be applicable to accessions will be analogous to the rules that are formulated to reconcile the claims of a person having an interest in the land and those of undoubted integrity and creditworthiness. [2.4.1]

CREDIT AGAINST ACTIONABLE CLAIMS AND OTHER GENERAL INTANGIBLES

(94) Now notwithstanding the recognition that accounts receivables are more liquid than goods held as inventory, advances against accounts receivables are generally restricted only to first class parties of undoubted integrity and creditworthiness. .[2.4.1]

(95) While it is true that advances against accounts receivables (or book debts) are not substitutes for advances by way of discount of bills which are amenable to better control, it has to be recognised that it is only a small portion of commercial liabilities that are eligible for bank advances which are covered by the Bill Market Scheme. Hence, it is essential that the legal framework governing advances against accounts receivables is sufficiently strengthened to facilitate that such advances are made available not merely to a few borrowers but also to all eligible commercial concerns and that there is no doubt as regards such advances being secured or unsecured. While in other countries there are adequate statutory provisions to safeguard advances against accounts receivables, the position in our country is entirely unsatisfactory. [2.4.2 and 2.4.3]

ASSIGNMENT OF ACCOUNTS RECEIVABLES

(96) The position in our country follows the Common Law rule under which choses in action are not legally assignable but an equitable assignment thereof has come to be recognised. Since the effect of an assignment of an account receivable is recognised only as an equitable assignment, the assignment is always subject to the equities in favour of the obligor. Again, it is enforceable only as a personal claim and enforceable against third parties only when they have notice

thereof. The provisions of our Transfer of Property Act dealing with actionable claims substantially reflects this position. There is also considerable doubt as to the assignability of benefits under executory contracts. These factors have by and large contributed to the lack of development of factoring business in our country. [2.4.4]

CONTRACT RIGHTS AS GOOD SECURITY

(97) In order to encourage the development of factoring business and improve the status of contract rights as good security, it shall be valid for the obligor on the account receivable and the bank's borrower to agree that on the assignment by the borrower of the obligation, the obligor will not raise against the assignee-bank any claim or defence which he may have against the borrower. If an assignment free from such defences is legally provided for, then commercial concerns may, while extending credit to their customers, provide a standard clause in the agreement that in the event of an assignment of the claim, the customer is not entitled to assert against the assignee any claim or defence he may have against the commercial concern. The claims comprised in such agreements can be bunched together and assigned in favour of a bank or a financing institution or a factoring institution. [2.4.6 and 2.4.7]

(98) Hence, an agreement by an obligor on a general intangible not to assert against the assignee any claim or defence that he has against his seller or lessor shall be enforceable by the assignee who takes the agreement for value, in good faith and without notice of such claim or defence. However, this provision need not apply to any claim in respect of consumer goods. This provision shall not also affect defences which may be asserted against a holder in due course of a negotiable instrument. [2.4.8]

SALE AND ASSIGNMENT OF ACCOUNTS RECEIVABLES

(99) It is necessary that our statutory scheme dealing with the personal property security law should cover both a sale of an account receivable as well as an assignment thereof as security. [2.4.9]

(100) The legal consequences flowing—

(a) when the assignment purports to be an absolute sale, and

(b) when assignment is intended as a security,

have to be clearly brought out. In the case of the former, the assignee or the secured party shall be under no accountable obligation to the debtor. However, it is necessary to provide for such accountability in the case of the latter. [2.4.10]

(101) Following the commercial practices in our country and the position in other countries, the statute should provide that where the agreement provides for assignment of an instrument or a general intangible but does not expressly specify whether it is with or without recourse to the debtor, it shall be presumed to be an assignment with such recourse. [2.4.11]

REALISATION OF SECURITY RE. ACCOUNTS RECEIVABLES

(102) The statutory framework of our personal property security law should provide clear-cut rules to facilitate the application of both the direct method of collection and the indirect method of collection of accounts receivables. [2.4.12]

(103) Where the assignment is without recourse to the debtor and in any event upon default, the secured party should be entitled—

(a) to require the obligor on a general intangible to pay to the secured party any further amount, if any, due from the obligor, by giving him a notice in writing whether or not the assignor was theretofore making collections on the property; and

(b) to take over any proceeds to which the secured party is entitled.

Where the assignment is without recourse to the debtor and in any event upon default, the secured party should be entitled to take steps to collect the further amounts, if any, due from the obligor and to take over any proceeds to which he is entitled, but the obligor may recognise the secured party's claims only subject to the provisions of any applicable law governing the assignment and payment. However, where the assignment is with recourse to the debtor and the assignee collects from the obligor on a general intangible or an instrument, he should be required to proceed in a reasonable manner, but he should be entitled to deduct his reasonable expenses of collection. Any payment in good faith, by an obligor on a general intangible or instrument, to the debtor or his assignee, after he is notified of the assignment, shall be valid against any person claiming a security interest in respect of the general intangible or instrument. [2.4.13 to 2.4.15]

REGISTRATION OF CHARGE ON ACCOUNTS RECEIVABLES

(104) Already the Companies Act, 1956, provides that a charge on the book debts of a company is registrable under section 125 of that Act. On similar lines we are suggesting for registration of security interests in the accounts receivables of a company. As regards firms and

sole proprietary concerns also we are recommending special provisions to enable registration of a charge against their accounts receivables. This should considerably facilitate giving credit against accounts receivables to small borrowers like retailers, traders and merchants who are vast in number in the business community and who do business without incorporation. [2.4.16 and 2.4.17]

CHARGE ON INVENTORY *VS.* CHARGE ON ACCOUNTS RECEIVABLES

(105) The protection of a security interest in an account receivable shall not affect a financing institution which has advanced against the inventory, the sale of which has given rise to the account receivable. Hence, it should be provided that the security interest of a transferee of a general intangible resulting from sale, lease or exchange of goods should be subordinate to a security interest which was already a perfected security interest when the goods became the subject of sale, lease or exchange. [2.4.18]

GOOD FAITH CHANGE IN ASSIGNED CONTRACT

(106) The statute should provide that so long as the right to claim payment under an assigned contract has not fully accrued by performance, and notwithstanding notice of the assignment, any modification of or substitution in the contract made in good faith and in accordance with reasonable standards and without material adverse effect upon either the assignee's right or the assignor's ability to perform the contract should be effective against the assignee and the assignee shall acquire corresponding right under the modified or substituted contract. But the assignee/secured party shall have the choice to decide whether he would permit such modification or not. In the event of his deciding not to permit it, it shall be open to him to provide in the security agreement constituting the assignment that any modification or substitution of the executory contract shall be regarded as a breach committed by the assignor. [2.4.21 and 2.4.22]

NO PROHIBITION RE. ASSIGNMENT OF DEBT

(107) In order that financing against accounts receivables may develop, it is necessary to provide that a term in any contract between a debtor on a general intangible and an assignor which prohibits assignment of the debt is ineffective. [2.4.23]

SPECIAL PROVISIONS TO BANKS REGARDING CERTAIN TYPES OF ADVANCES

(108) It is necessary that banks are given special recognition in the statutory scheme to govern transactions secured against personal property. [2.5.1]

(109) Advances by banks under certain circumstances may have to be treated as creating in their favour a perfected security interest for a temporary period without the necessity for banks taking possession of the security or registration of their security interest. [2.5.2]

RE. TRUST RECEIPTS

(110) In the light of the earlier discussion on the subject and in order to facilitate trust receipt transactions and make them available to the comparatively smaller class of borrowers, it is necessary to provide that—

(1) when the secured party is a bank and gives, under a written security agreement, value, not being an antecedent debt or a liability, a security interest in an instrument or a negotiable document of title connected with such value shall be deemed to be perfected without the taking of possession of the instrument or document, for a period of thirty days from the date on which the bank gives such value;

(2) a perfected security interest held by a bank in—

(a) an instrument which the secured party delivers to the debtor for the purpose of—

(i) ultimate sale or exchange, or

(ii) presentation, collection or renewal, or

(iii) registration of transfer, or

(b) a negotiable document of title, or goods held by a bailee and not covered by a negotiable document of title, which document of title or goods the secured party makes available to the debtor for the purpose of—

(i) ultimate sale or exchange, or

(ii) loading, unloading, storing, transporting, shipping or transhipping, or

(iii) manufacturing, processing, packaging or otherwise dealing with the goods in a manner preliminary to their sale or exchange,

remains perfected for a period of thirty days after the property comes under the control of the debtor, but priority between conflicting security interests in the goods is subject to the preference under the scheme as regards purchase money security interests in inventory; and

(3) after the expiry of the above said thirty day period, perfection should depend upon compliance with the other applicable provisions of the statute. [2.5.3]

RE. BANKS' CHARGE OVER THE ASSETS OF FIRMS

(111) Under the scheme which we are recommending, it would be possible for banks to register their security interests when their advances are made to firms and proprietary concerns under the suggested new Part III-A of the Registration Act, 1908. While registration under Part III-A should be available to banks at their option, they should not be under a compelling necessity to effect such registration in order to get the remedies against the security, which are available to perfected security interest holders. [2.5.6]

RE. UNPERFECTED SECURITY INTERESTS

(112) The claims of a secured party having a security interest in the property should be subordinate to—

(i) the claims of a subsequent purchaser of the property where the purchase was in good faith for value without knowledge of the unperfected security interest,

(ii) the claims of an unsecured creditor who, whether before or after the creation of an unperfected security interest, gets the property attached through judicial proceedings, and

(iii) the claims of the official assignee, receiver in insolvency or liquidator in a winding up,

unless, at the time when a claim arises under any of the above items, he has a perfected security interest in the property. [2.5.7]

SPECIAL RULES RE. BANKS

(113) Even as regards unperfected security interests in the assets of firms and proprietary concerns, priority should be given to the security interest of a bank where the property is not a motor vehicle, fixture or crops. This provision should considerably facilitate small business people in availing themselves of bank credit. [2.5.8]

(114) As regards the enforceability of a security interest in favour of a bank, it is also necessary and desirable not to make any distinction based on the nature of the security interest, that is, whether it is perfected or unperfected. On the contrary, with reference to an unperfected security interest in favour of a secured party other than a bank, certain special rights which allow him to proceed against the secured property directly or without recourse to court should not be extended. Thus, in the scheme the right to take possession of the property without recourse to court, the right to dispose of the property in the event of default and the right to appoint a receiver should be given only to perfected security interest holders and to banks irrespective of whether their security interests are perfected or not. [2.5.9]

(115) There should be a common provision available to banks and term-lending institutions which would facilitate their proceeding against the secured property in the event of default by the borrower. Timely action to preserve the secured property is necessary especially with reference to advances against movable assets. Since public funds are involved, it is natural that the State help should be available to banks and term-lending institutions in seeing that the secured property is not secreted away or is otherwise fraudulently disposed of by the defaulting borrowers. [2.5.11]

(116) While it is essential and desirable to extend the principle of section 45S of the Banking Regulation Act, 1949, to cover advances made by banks and term-lending institutions even as they function as going concerns so that they can obtain the effective help of the authorities to get possession of the secured property on the default by the borrower, it is not necessary that the proceedings should be placed beyond the pale of judicial review. In view of the above, it is necessary to have a specific provision in our personal property security law on the following lines:

(a) A bank may request, in writing, the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, within whose jurisdiction the property is situate or is found, to assist the bank in taking possession of the property or the document relating thereto in the case of a general intangible, and the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, as the case may be, shall, on such a request being made to him, assist the bank in taking possession of the property or the document relating thereto in the case of a general intangible.

(b) For the purpose of securing such compliance, the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, as the case may be, may take or cause to be taken such steps and use or cause to be used such force as may, in his opinion, be necessary. [2.5.13]

REGISTRATION MACHINERY

(117) What is immediately necessary for the development of a comprehensive scheme of personal property security law is a comprehensive legal vision of the scope and operation of the registration machinery now available with reference to registration of security interests in personal property. [2.6.3]

(118) The effect of registration or non-registration of a security interest pursuant to the provisions contained in—

(i) the Companies Act, 1956,

(ii) the Motor Vehicles Act, 1939, and

(iii) the Registration Act, 1908

is now vastly different. Non-registration under the Companies Act provisions makes a security interest void against the liquidator and any creditor of the company. If a security interest in a motor vehicle by way of hire-purchase/hypothecation is not recorded, it does not as such have any adverse effect, though it exposes the security interest holder to the possible loss of the security by reason of the vehicle being transferred to third persons who may take it without any knowledge of the security interest in favour of the hire-purchase financier/hypothecatee. Non-registration of a hire purchase financier's interest does not now legally (under the instalment sale concept) affect him though it may affect his ability to trace the vehicle in the event of default. Non-registration of a fixture charge may avoid the creation of a security interest were a court to view the fixture as having ceased to be a movable asset. Non-registration of a charge on other movable assets under the provisions of the Registration Act [section 18(d)] does not deny any positive advantage except probably that registration helps to establish in some doubtful cases the genuineness of the security agreement. These differing and varying consequences of non-registration adversely affect proper recognition of the functional role of the security. [2.6.5]

(119) Now the different machinery available for registration of security interests in personal property has to be viewed as parts of a whole and well-knit scheme in order that the functional role of security in the development of the economy could be fully employed. To this end, the requirement as to registration as well as consequences of non-registration will have to be suitably adapted having regard to practical circumstances. With such basic approach, we have to consider the role of the registration machinery under the Companies Act, the Motor Vehicles Act and the Registration Act. It is obvious that necessary changes will have to be made to the applicable provisions and some administrative adjustments ensured for the efficient functioning of the registering authorities with a view to help economic development and to facilitate the disbursement of credit for the priority sectors and for the smaller and weaker sections of the borrowers. [2.6.6 and 2.6.7]

(120) Under the Companies Act, what is recorded is the security interest and not the instrument creating the security interest. This contrasts with the scheme of Registration Act where what is recorded is the instrument creating the security interest. The difference becomes apparent when we find that a security interest created without any formal document, *e.g.*, mortgage by deposit of title deeds with reference to an immovable property could be registered under the Companies Act. Since

there is no instrument evidencing its creation, the question of registration with reference to this mortgage under the Registration Act does not as such arise. [2.6.8]

(121) Under the scheme of our personal property security law, for the purpose of perfecting a security interest, a recording of the particulars regarding the security interest with the appropriate authority is all that is necessary. Such recording of the security interest in a public register or a public document will enable third persons dealing with the secured property to become aware of the claims of the secured party. [2.6.9]

(122) Though under the Companies Act a period of thirty days has been given for filing an application for registration of a charge, public notice of the charge does not happen until actual registration. Special provision is required to cover the period between the filing of the application and the actual entry in the register about the security interest. Hence, there should be a provision providing that, immediately on the filing of the particulars, the Registrar shall make a provisional entry in the register showing that an application has been filed with him and indicating the nature of the transaction, the names and addresses of the parties thereto and the description of the property to which the transaction relates. Consequent to this provision, for ascertain the date from which notice of the charge shall be presumed, it is the date of the provisional entry that should be considered. [2.6.10]

(123) While considering registration of security interests in personal property with the authorities constituted under the Registration Act, 1908, we will have to keep in view the following factors:

(a) There is a void at present with reference to the creation of security interests in the personal property of firms and proprietary concerns — this can be filled only by appropriately adapting the registration machinery set up under the Registration Act, 1908.

(b) The requirements with reference to registration of security interests in the personal property of firms and proprietary concerns will have to be considerably simplified and should be capable of being complied with the minimum of formalities and administrative effort.

(c) There has to be some indication of the place where registration is required to be made so that persons dealing with the firm or sole proprietary concern may reasonably be aware of the place where such security interest would have been recorded.

(d) With reference to fixtures and crops which are linked with the land, the appropriate authority with whom registration of the security interests in respect of such assets is to be made should be the authority having territorial jurisdiction over the land. [2.6.11]

(124) Having regard to the above considerations, we have suggested a new Part (Part III-A) in the Registration Act, 1908. Here we may add that even while the registration scheme under the Registration Act, 1908, and the earlier statutes were introduced in our country, it was the intention to develop the registration scheme to cover also transfer of movable assets. It was intended to be done gradually. But the complexities of the situation have resulted in the postponement of this development so far. Time is now ripe for toning up of our registration scheme to provide for registration of security interests in personal property since thereby our credit-security law could effectively contribute to economic development. [2.6.11]

(125) Registration of a security interest in personal property (other than fixtures and crops) may be effected only in the office of the Registrar in whose district the debtor ordinarily carries on business or if he does not carry on business, where he ordinarily resides. A debtor who has a Permanent Account Number for purposes of Income-tax shall be deemed to carry on business at the place where he has the Permanent Account Number. [2.6.12]

(126) Under the Registration Act, the Registrar is the District Registrar and hence search for security interests in the assets of firms and proprietary concerns (other than fixtures and crops) could be made in the District Registrar's office for the whole district. This will considerably eliminate the difficulties that would otherwise be caused if the register with reference to a district is to be split up among different sub-registries. [2.6.13]

(127) An application for registration of a security interest in personal property, other than a fixture or crops, shall be signed and attested in the manner prescribed and shall contain specified essential particulars. [2.6.14]

(128) For registration of security interests in personal property, other than fixtures and crops, the District Registrar should be required to open a separate book wherein he can record the particulars of the security interests. The register should be a nominally indexed register, giving also reference to the Permanent Account Numbers, if any, for those with reference to whose assets applications have been made for recording security interests therein. [2.6.15]

(129) The register, which may be numbered as Book No. 6, shall be available to the public for inspection and searches therein may be provided by rules. Registrars may also be authorised to issue certificates regarding encumbrances noted in Book No. 6 in the name of the indexed borrowers, in an appropriate form that may be prescribed by Government. [2.6.17]

(130) Under the scheme of the personal property security law, the role of the Registrar will be that of a recording officer and he is not required to go into the veracity of the statements. Hence, it is unnecessary to require personal attendance of the parties before the Registrar, unless the parties choose to do so. [2.6.18]

(131) Hence, an application for registration of a security interest in personal property should be permitted to be sent by registered post. The Registrar should also be required to send the certificate of registration by registered post at the cost of the applicant. The rules may provide the manner for payment of the registration charges that may be incurred by the Registrar. [2.6.20]

(132) A security interest in a fixture or crop has to be registered with the Sub-Registrar of Assurances in whose territorial jurisdiction the land to which the fixture is affixed or on which the crop is grown is situate. The registration of a security interest in a fixture or crop should be effected generally in the manner that would be provided for with reference to application for registration of a security interest in other forms of personal property. It should also be possible to effect such registration by post. But the entry of the fixture charge or the security interest in the crop will have to be made by the Sub-Registrar in the book maintained by him for recording transactions in immovable property, that is, Book No. 1. If necessary, to facilitate the entry regarding security interests in fixtures and crops, appropriate rules may be framed by Government. [2.6.21 to 2.6.23]

(133) Consistent with the scheme regarding registration of security interests in personal property, the elaborate requirements specified in the Registration Act, such as calling personal attendance of the parties, and requiring an admission from them of the passing of consideration, genuineness of the signature, awareness of the nature of the transactions, *etc.*, are all unnecessary. [2.6.24]

REGISTRATION OF CHARGE ON MOTOR VEHICLES

(134) The motor vehicles authorities in all the States now keep a register of the certificates of registration of vehicles registered with them under a card index system. These registers are now maintained

in the district centres. When a transfer of registration is sought within a State, the registration card is also transferred to the other district. But when a vehicle's registration is sought to be transferred from one State to another, it involves a re-registration in the other State and cancellation of registration with the authorities in the original State. Thus, we have a fairly satisfactory machinery for recording security interests in motor vehicles. What is required is only to strengthen the legal framework regarding registration of a security interest in the certificate of registration. In this process, it has to be ensured that there is no appreciable additional administrative burden involved. This is necessary having regard to the number of motor vehicles and the need to ensure expedition in getting information regarding security interests in motor vehicles. [2.6.25 and 2.6.26]

(135) We have also provided—

(a) for cancellation of a security interest noted in the certificate of registration;

(b) provision for obtaining the consent of the secured party when there is a transfer of ownership of a motor vehicle which is subject to the security interest noted in the certificate of registration and when there is an application for issue of a duplicate certificate of registration; and

(c) the issue of a fresh certificate of registration (not a mere duplicate thereof) in the name of the secured party having a registered security interest, when such a person is able to satisfy the registering authority that he has taken possession of the vehicle being entitled to do so owing to the default of the owner.

Consistent with the scheme of the provisions for recording a security interest in the certificate of registration, we have also suggested some amendments to the provisions of the Motor Vehicles Act to protect the security interest of a secured party to keep him aware of any factors which are likely to adversely affect his interest. [2.6.30]

RIGHTS, OBLIGATIONS AND REMEDIES OF PARTIES

(136) In considering the rights and remedies that should be available to the parties to a security agreement, we should have regard to the following factors :

(a) The special position of banks and allied financial institutions which are required to extend credit based on certain priorities and other policies laid down by the credit planning authorities, which have to be suitably recognised in the framework of the personal property security law;

(b) while the rights of parties to have access to courts to have their rights and remedies should not be curtailed, the legal framework should minimise the occasions for recourse to judicial proceedings for settling the rights of parties;

(c) with reference to persons other than banks, while registered security interest holders may be given rights to proceed against the property directly and without recourse to court, as regards unregistered security interest holders it may not be desirable or necessary to confer on them such rights;

(d) with reference to persons who are in possession of the secured property, the law now enables such pledgees to dispose of the property directly and without recourse to court in the event of default — it is necessary to preserve this right; and

(e) the law should also recognise certain basic rights in the debtor-borrower so that unconscionable or unreasonable transactions or arrangements operating to his prejudice are not encouraged. [2.7.1]

(137) The right to take possession of the secured property upon default shall be available to banks and all registered security interest holders. In taking possession, the secured party may proceed without judicial process if this can be done without breach of peace or he may apply to the court for taking possession. If the secured party happens to be a bank, it can invoke the assistance of the authorities pursuant to the provisions earlier we have recommended. If the security agreement so provides, the secured party may require the debtor to assemble the property and make it available to the secured party at a place to be designated by the secured party, which is reasonably convenient to both the parties. With reference to registered security interests, the secured party may also reasonably render the goods in the possession of the debtor temporarily unusable. But this provision shall not apply to consumer goods or inventory. [2.7.3 to 2.7.5]

(138) The right to appoint a receiver may be provided for in the security agreement but shall be capable of being exercised only by banks and all perfected security interest holders. With reference to such appointment of receiver, we have suggested a suitable provision. [2.7.7]

(139) The right to dispose of the property upon default will be available to banks and all perfected security interest holders. The secured party may dispose of the property in its then condition or after any reasonable repairing, processing or preparation for disposition. [2.7.9]

(140) The proceeds of disposition shall be applied in the following order:

(a) the reasonable expenses of holding, repairing, processing, preparing for disposition and disposing of the property and, to the extent provided for in the security agreement and not prohibited by law, any other reasonable expenses incurred by the secured party;

(b) the satisfaction of the obligation secured by the security interest of the party making the disposition; and

(c) the satisfaction of the obligation secured by any subordinate security interest in the property, if written demand therefor is received by the party making the disposition before the distribution of the proceeds is completed:

Provided that before satisfying the obligation of the subordinate security interest holder, the secured party shall give notice of such written demand to the debtor and if the debtor, within twentyone days from the date of receipt of the notice, expresses his objection to such satisfaction, the secured party shall deposit the surplus proceeds in the court having jurisdiction in accordance with the provisions of the statutory scheme. [2.7.10]

(141) The interest of subordinate security interest holders should be suitably safeguarded. They may be asked to furnish reasonable proof before their claims are considered. [2.7.11]

(142) A secured party, who is entitled to dispose of the property without recourse to court, shall also be entitled to dispose of the property without taking possession of the same. In other words, such a creditor should be capable of assigning the title to the property without taking possession of the property by a transaction which is otherwise *bona fide*. A provision facilitating such a procedure will considerably help banks and other financing institutions to concentrate on disbursement of credit for productive purposes and save them from the worries regarding realisation of the security by selling the property to persons who may be willing to take the several steps and other allied measures which may be necessary to perfect their title. [2.7.12]

(143) Methods of disposition have to be reasonable and should be in accordance with commercial practice. But the disposition may be by public sale, private sale, lease or otherwise. Subject to suitable notice

being given to the debtor, the disposition may be at any time and place and on any terms so long as every aspect of the disposition is reasonable. The secured party shall dispose of the property in whole or in part within a reasonable time and may retain the property till then. [2.7.13]

(144) The debtor should be given suitable notice before the secured party entitled to dispose of the property without recourse to court exercises his right to do so. But this rule as regards notice need not be observed where the property will decline speedily in value or is of a perishable nature. This notice has to be given to the debtor and to any other person who has a registered security interest in the property or about whose security interest in the property the secured party is already aware. Not less than fifteen days' notice in writing is necessary. [2.7.14]

(145) The notice from the secured party proposing to dispose of the property in the event of default shall contain the specified particulars and shall be sent by registered post acknowledgement due. [2.7.15]

(146) With the permission of the court, which may be given subject to conditions, the secured party may purchase the property or any part thereof at a public sale. [2.7.16]

(147) Where the property is disposed of by the secured party without recourse to court in accordance with his rights, the disposition shall discharge the security interest of the secured party making the disposition. If such disposition is made to a *bona fide* purchaser for value, it shall also discharge any subordinate security interest and terminate the debtor's interest in the property. A *bona fide* purchaser for value under such disposition shall take free from all such security interests even though the secured party fails to comply with any requirements to be observed in making the disposition. In the case of a public sale, to get such protection the purchaser shall have no knowledge of any defects in the sale and he should not buy the property in collusion with the secured party, other bidders or the person conducting the sale. [2.7.17]

(148) On the application of the secured party or the debtor or any person having an interest in the property, the court may appoint a receiver on such terms and conditions as it may specify, if it considers such appointment just and necessary. [2.7.18]

(149) At any time before the secured party has disposed of the property by sale or exchange or contracted for such disposition, the debtor or any person other than the debtor who is the owner of the property, or any secured party other than the secured party in possession, may either—

(a) redeem the property by tendering fulfilment of all obligations secured by the property, or

(b) reinstate the security agreement by paying the sums actually in arrears, exclusive of the operation of any acceleration clause, or by curing any other default by reason whereof the secured party has become entitled to dispose of the property,

together with a sum equal to the reasonable expenses incurred for holding, repairing, processing, preparing the property for disposition and in arranging for its disposition, and, to the extent provided for in the security agreement, the reasonable legal expenses. [2.7.20]

(150) Where a secured party in possession of the property is not complying with his obligations, the debtor or any other person who is the owner of the property or the creditors of either of them or any person who has an interest in the property, may apply to the court, and the court may, upon hearing such application, direct the secured party to comply with his obligations. In the event of any loss arising consequent on the secured party not complying with his obligations in proceeding against the property, he shall be liable for loss or damage that may be caused by such failure. [2.7.21]

(151) The debtor should be entitled to require from the secured party the particulars of his indebtedness. In order that banks and other financing institutions are not put to unnecessary expense on this account, such information shall be furnished at the cost of the debtor. [2.7.22]

(152) It is necessary to recognise certain essential rights in favour of the debtor, which should be available to him even if the security agreement provides to the contrary. Such essential rights shall relate to —

(i) the provisions requiring the secured party to account for the surplus proceeds of the property if he disposes of the same;

(ii) the provisions providing the requirements to be complied with by the secured party in the disposition of the property;

(iii) the provisions dealing with the secured party's liability for his failure to comply with his obligations; and

(iv) the provisions dealing with the information to be furnished by the secured party about the indebtedness of the debtor. [2.7.23]

(153) The secured party's rights to proceed against the property shall not extend to the whole or any portion of the property in the possession of the debtor which would otherwise be exempt from attachment under the provisions of the Code of Civil Procedure, 1908. [2.7.24]

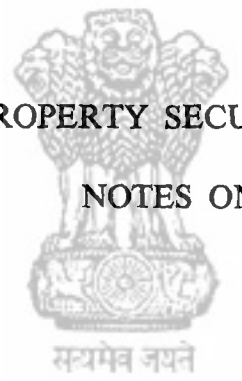
P. V. RAJAMANNAR,

Chairman.

R. KRISHNAN,

Secretary.

MADRAS,
21*st October*, 1977.



PART IV

PERSONAL PROPERTY SECURITY BILL WITH NOTES ON CLAUSES


सत्यमेव जयते

THE PERSONAL PROPERTY SECURITY BILL, 197

(WITH NOTES ON CLAUSES)

STATEMENT OF OBJECTS AND REASONS.

ARRANGEMENT OF CLAUSES

CLAUSES

CLAUSES

CLAUSES

CHAPTER VI

RIGHTS, OBLIGATIONS AND REMEDIES OF PARTIES

CLAUSES

CLAUSES

SCHEDULES

STATEMENT OF OBJECTS AND REASONS

This Bill is intended to provide a comprehensive statutory scheme which would govern all kinds of security agreements dealing with all forms of personal property like advances against stock-in-trade, accounts receivables, other types of goods like fixtures and machinery, crops, instruments and documents of title to goods. The legislation is intended to fill the gap in our credit-security law with reference to advances against personal property.

2. The scheme employs neutral terminology and provides incentives to banks and other financing institutions extending purpose and production-oriented credit. It also covers instalment credit provided by both banks and hire-purchase financing institutions. Appropriate preferences are given in the statutory scheme for purchase money credit, current crop loans and trust receipt type of facilities. The scheme aims to implement an overdue recommendation of the Indian Central Banking Enquiry Committee (1931) as regards the necessity to enhance the status of trust receipts.

3. The Banking Laws Committee, set up by the Government of India, has initiated a Project Study for evolving a statutory scheme and on the draft for legislation prepared by the Project Study Team the Committee has elicited the comments from banks and other financial institutions and their constituents. In the light of such suggestions and comments, including those received by the Committee from both Indian and foreign experts, this Bill has been prepared by the Banking Laws Committee to give effect to the recommendations contained in its Report on Personal Property Security Law.

4. The Notes on Clauses explain the various provisions contained in the Bill.


सत्यमेव जयते

THE PERSONAL PROPERTY SECURITY BILL, 197

BILL NO. OF 197

A Bill to reform and clarify the law regarding security interests in goods, fixtures, documents of title, instruments, actionable claims and other general intangibles, to facilitate the integrated economic development and the distribution of the material resources of the community to subserve the common good, and, in particular, to enable banks to contribute effectively towards the fulfilment of these objectives.

Be it enacted by Parliament in the ..... year of the Republic of India as follows:—

CHAPTER I

PRELIMINARY

1. *Short title, commencement and extent.*—(1) This Act may be called the Personal Property Security Act, 197

(2) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint, and different dates may be appointed for different provisions of this Act, and any reference in any provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

(3) It extends to the whole of India except the State of Jammu and Kashmir, to which State it shall extend subject to modifications, if any, which the President may notify in consultation with the Government of that State.

2. *Definitions.*—In this Act, unless the context otherwise requires,—

(i) "accession" means goods that are installed in or affixed to any other goods ;

(ii) "bank" means—

(a) a "banking company" as defined in the Banking Regulation Act, 1949 ; or

(b) the State Bank of India constituted under the State Bank of India Act, 1955 ; or

(c) a "subsidiary bank" established under the State Bank of India (Subsidiary Banks) Act, 1959 ; or

(d) a "corresponding new bank" constituted under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 ; or

(e) a "co-operative bank" as defined in section 2(bii) of the Reserve Bank of India Act, 1934 ; or

(f) the Reserve Bank of India established under the Reserve Bank of India Act, 1934 ; or

(g) the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 ; or

(h) the Industrial Finance Corporation of India established under the Industrial Finance Corporation Act, 1948 ; or

(i) a "State Financial Corporation" established under the State Financial Corporation Act, 1951 ; or

(j) a financial institution providing instalment credit, whether in the form of hire-purchase agreement or otherwise, in relation to motor vehicles, which accepts deposits from the public and which is notified by the Central Government in the Official Gazette in this behalf ; or

(k) any other public financing institution which the Central Government may notify in the Official Gazette in this behalf ;

(iii) "building" includes a structure, erection, mine or work built, erected or constructed on or in land ;

(iv) "building materials" includes goods that are or become so incorporated or built into a building that their removal therefrom would necessarily involve the removal or destruction of some other part of the building and thereby cause substantial damage to the building apart from the value of the goods removed ;

(v) "company" means a company as defined in section 3 of the Companies Act, 1956, and includes a foreign company within the meaning of section 591 of that Act ;

(vi) "consumer goods" means goods, other than motor vehicles, that are used or acquired for use by a debtor being an individual for his personal, family or household purposes ;

(vii) "court" means the court having jurisdiction under section 10 of the Companies Act, 1956 where the debtor is a company and the creditor is not a co-operative society, a Registrar appointed under the Co-operative Societies Act of a State where the creditor is a co-operative society, and in any other case the Civil Court of competent jurisdiction ;

(viii) "creditor" includes an assignee for the benefit of creditors, a legal representative, the official assignee or receiver in insolvency, a liquidator, a receiver, an executor or an administrator ;

(ix) "debtor" means a person who owes payment or other performance of the obligation secured, and includes an assignor of a general intangible ; and where the debtor and the owner of the property are not the same person, the term "debtor" means the owner of the property in any provision of this Act dealing with the property, the obligor in any provision dealing with the obligation, and may include both when the context so requires ;

(x) "default" means the failure to pay or otherwise perform the obligation secured when due or the occurrence of any event whereupon under the terms of the security agreement the security becomes enforceable ;

(xi) "document of title" means a document which purports to be issued by or addressed to a bailee and purports to cover such goods in the bailee's possession as are identified or fungible portions of an identified mass, and which in the ordinary course of business is treated as establishing that the person in possession of the document is entitled to receive, hold and dispose of it and the goods it covers ;

(xii) "fixture" means goods embedded in the earth, or affixed to what are so embedded (whether or not they thereby become immovable property), and includes—

(a) goods that are severable from a building or land by unscrewing, unbelting, unclamping or uncoupling or by some other method of dsconnection ; and

(b) machinery installed in a building, which is capable of being removed without substantial damage to the building apart from the removal or destruction of the bed or casing on or in which the machinery is set and the making or

enlargement of an opening in the walls of the building sufficient for the removal of the machinery ;

but does not include building and building materials ;

(xiii) "fungible" with respect to goods means goods of which any unit is, by nature or usage of trade, the equivalent of any other like unit ; but goods shall be deemed fungible for the purposes of this Act to the extent that under a particular agreement or document unlike units are treated as equivalents ;

(xiv) "future property" means personal property to be manufactured, produced or acquired by the debtor after the making of the security agreement ;

(xv) "general intangible" includes actionable claims or other intangibles, but does not include a document of title or an instrument ;

(xvi) "goods" means any movable property including a fixture, growing crops, grass and standing timber, but does not include an instrument, a document of title and a general intangible ;

(xvii) "instrument" means a bill of exchange or a promissory note or a cheque within the meaning of the Negotiable Instruments Act, 1881, or an indigenous negotiable instrument (hundi), or a share certificate, stock certificate, share warrant, bond, debenture or the like or any other writing which evidences a right to the payment of money and which in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, but does not include a document of title ;

(xviii) "inventory" means goods—

(a) that are held by a person for sale or lease ; or

(b) that are raw materials, goods in process or goods intended for consumption in any industry, business or profession ;

(xix) "motor vehicle" means a motor vehicle as defined in the Motor Vehicles Act, 1939 ;

(xx) "negotiable document of title" means a document of title, title to which is transferable merely by delivery or by endorsement and delivery, as the case may be ;

(xxi) "negotiable instrument" means a bill of exchange or a promissory note or a cheque governed by the Negotiable Instruments Act, 1881, or an indigenous negotiable instrument (hundi),

a share warrant or any other instrument, title to which is transferable merely by delivery or by endorsement and delivery, as the case may be ;

(xxii) "personal property" means goods, a fixture, a document of title, an instrument or a general intangible ;

(xxiii) "prescribed" means prescribed by rules framed under this Act ;

(xxiv) "proceeds" means identifiable or traceable personal property in any form received or obtained on the collection or disposition of the property, or on the collection or disposition of personal property so received or obtained, and includes a payment by an insurer or any other person as indemnity or compensation for the loss of or damage to the property, and any payment made in total or partial discharge of a general intangible or an instrument or any right to such payment ;

(xxv) "the property" means personal property that is subject to a security interest ;

(xxvi) "purchase" includes taking by sale, lease, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in the property ;

(xxvii) "purchaser" means a person who takes by purchase ;

(xxviii) the expressions "registration", "registration of security agreement" and "registration of security interest" shall mean registration of the security interest in the property in accordance with Chapter VII of this Act ;

(xxix) "rules" means rules framed under this Act ;

(xxx) "secured party" means a person in whose favour there is a security interest, including a person to whom a general intangible has been assigned or sold ;

(xxxi) "security agreement" means an agreement which in substance creates or provides for a security interest ;

(xxxii) "security interest" means an interest in personal property which secures payment or performance of an engagement which may give rise to a pecuniary liability, and includes—

(a) an interest arising from an assignment or sale of a general intangible whether or not intended as a security ;

(b) an interest of a consignor under a consignment agreement not intended as a security ; and

(c) an interest of a lessor under a lease where the lease is for a term of more than one year;

(xxxiii) "security interest for purchase money" means a security interest that is—

(a) taken or reserved by the seller of the property to secure payment of the whole or part of the price; or

(b) taken by a person who gives value for the purpose of enabling the debtor to acquire rights in the property, if such value is applied to acquire such rights; or

(c) taken by the consignor under a consignment agreement not intended as a security; or

(d) taken by a lessor under a lease where the lease is for a term of more than one year;

(xxxiv) "value" means any consideration sufficient to make a contract valid, and includes an antecedent debt or liability.

CHAPTER II

General Applicability

3. *Application of Act.*—Subject to the provisions of section 4, this Act applies—

(a) to every security agreement without regard to its form and without regard to the person who has title to the property, including any lease intended as a security;

Explanation.—Any transaction purporting to be a pledge, mortgage, hypothecation, floating charge, trust receipt, conditional sale or hire-purchase (whether or not in the hire-purchase agreement the hirer is given an option not to purchase) or to postpone the passing of title until after full payment of the purchase price shall be regarded as creating or providing for a security interest;

(b) and to every assignment of a general intangible whether or not intended as a security, but not to an assignment for the general benefit of creditors.

4. *Where Act does not apply.*—This Act does not apply—

(a) to a lien given by statute, except as regards the lien for materials furnished or services rendered as provided under section 48;

(b) to any right of set-off;

(c) to any security interest in a vessel as defined in the Merchant Shipping Act, 1959, or in an aircraft ; and

(d) to a transaction governed by the Hire-Purchase Act, 1972.

5. *Money-lending legislation not affected.*—Nothing in this Act shall affect the operation of any provisions relating to money-lenders and moneylending legislation or the provisions of any legislation relating to pawn-brokers.

6. *Description of the property.*—For the purposes of this Act, any description of the property or of any immovable property to which the property is affixed or in which it is embedded is sufficient, if it reasonably identifies what is described.

CHAPTER III

General Effect of Security Agreement

7. *Effectiveness of security agreement.*—Except as otherwise provided by this Act or any other law, a security agreement is effective according to its terms between the parties, and likewise against the purchasers of the property and against creditors.

8. *When security interest attaches.*—(1) A security interest attaches when—

(a) value is given, and

(b) the debtor gets rights in the property,

unless the parties intend it to attach at a later date, in which case it attaches in accordance with the intention of the parties.

(2) For the purposes of sub-section (1), the debtor gets no rights in—

(a) yield of trees until such yield has come into existence ;

(b) crops until they become growing crops ;

(c) grass until it becomes growing grass ;

(d) fish until they are caught ;

(e) oil, gas, or other minerals until they are extracted ; or

(f) timber until it is fit to be cut.

9. *Enforceability of security interest.*—Subject to the other provisions of this Act, a security interest which has attached shall not be enforceable with respect to the property unless the property is in the possession of the secured party by reason of agreement, or the

debtor has signed the security agreement which contains a description of the property and, in addition, a description of the land concerned when the security interest covers existing or future yield of trees or crops or grass or timber whether growing or to be grown.

10. *Future property.*—When a security agreement provides for a security interest in future property, the security interest attaches in accordance with section 8 even without appropriation of the property to the security interest.

11. *Future property as security when deemed to be for new value.*—Where a secured party makes an advance, incurs an obligation, releases a perfected security interest or otherwise gives new value which is to be secured in whole or in part by future property, his security interest in the future property shall be deemed to be taken for a new value then given if the debtor acquires his rights in the property either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after such value is given.

12. *Security interest in goods returned or repossessed.*—(1) A security interest in goods that are the subject of a sale, lease or exchange and that are returned to, or repossessed by,—

(a) the person who sold, leased or exchanged them, or

(b) a transferee of a general intangible resulting from the sale or lease of them,

re-attaches to the extent that the secured indebtedness remains undischarged.

(2) An assignee of a general intangible arising out of a sale or lease has a security interest in such returned or repossessed goods.

13. *Security interest in proceeds.*—Except where this Act otherwise provides, a security interest continues in the property notwithstanding the sale, exchange or other disposition thereof, unless the disposition free of the security interest was authorised by the secured party in the security agreement or otherwise, but in either case the security interest continues in any identifiable proceeds.

14. *Future advances.*—If a security agreement made to secure a future advance, the performance of an engagement or the balance of a running account, expresses the maximum to be secured thereby, a subsequent security agreement over the same property shall, when made with notice of the prior security interest, be postponed to the prior security interest in respect of the advance or debits not exceeding the maximum, though made or allowed with notice of the subsequent security interest.

15. *Effect of debtor's right of disposition.*—A security interest is not invalid or fraudulent against creditors merely by reason of liberty to the debtor to use, commingle or dispose of all or part of the property (including returned or repossessed goods), or to collect from or compromise with debtors on general intangibles, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace the property. This section does not relax the requirement as to possession where perfection of a security interest depends upon possession of the property by the secured party or by a bailee.

16. *Security interest as security.*—A secured party may by entering into a security agreement create a security interest upon his security interest in the property on terms that do not impair his debtor's right to redeem the property.

17. *Agreement not to assert defence against assignee.*—An agreement by an obligor on a general intangible not to assert against an assignee any claim or defence that he has against his seller or lessor is enforceable by the assignee who takes the assignment for value, in good faith and without notice of such claim or defence.

Exception (1).—This section shall not apply to any claim to consumer goods.

Exception (2).—This section shall not affect defences which may be asserted against the holder in due course of a negotiable instrument under the Negotiable Instruments Act, 1881.

18. *Assignee of a general intangible.*—(1) Except where a debtor on a general intangible has made an enforceable agreement not to assert against an assignee defences or claims arising out of a contract, the rights of an assignee are subject to—

(a) all the terms of the contract between the debtor on a general intangible and the assignor and any defence or claim arising therefrom; and

(b) any other defence or claim of the debtor on a general intangible against the assignor that accrued before the debtor on a general intangible received notice of the assignment.

(2) So long as the right to claim payment under an assigned contract has not fully accrued by performance, and notwithstanding notice of the assignment, any modification of or substitution in the contract made in good faith and in accordance with reasonable standards and without material adverse effect upon either the assignee's

rights or the assignor's ability to perform the contract is effective against the assignee and the assignee acquires corresponding rights under the modified or substituted contract; but the assignee and the assignor may agree that such modification or substitution is a breach by the assignor.

(3) The debtor on a general intangible may pay the assignor until the debtor on the general intangible receives notice from either the assignor or the assignee, reasonably identifying the relevant rights, that the debt has been assigned, and, where the notice has not been given by the assignor, the assignee shall, if requested by the debtor on the general intangible, furnish proof within a reasonable time that the assignment has been made, and, if he does not do so, the debtor on the general intangible may pay the assignor.

(4) A term in any contract between a debtor on a general intangible and an assignor which prohibits assignment of the whole or a part of a debt is ineffective.

19. *Seller's warranties.*—Except as provided in section 17, where a seller retains a security interest for purchase money in goods, the Sale of Goods Act, 1930, governs the contract of sale of goods and any exclusion, waiver, limitation or modification of the seller's conditions and warranties.

20. *Stamping of security agreements.*—Any security agreement purporting to create a security interest in any personal property shall, for the purposes of the Stamp Law, be regarded only as an ordinary agreement.

21. *Charges for registration under Registration Act.*—Notwithstanding anything contained in any other law, the charges for registration of any security interest in a fixture or crops under Part III-A of the Registration Act, 1908, shall be the same as the charges payable for the registration of an agreement relating to a movable property, which is optionally registrable.

CHAPTER IV

PERFECTION

22. *Security interest when perfected.*—(1) A security interest is perfected when it has attached and all steps required for perfection under any provisions of this Act have been taken, in whatever order they are taken.

(2) Where steps have been taken for perfection, otherwise than by registration, before the security interest attaches, the security interest is perfected when it attaches.

23. *Continuity of perfection.*—(1) If a security interest is originally perfected in any way permitted under this Act and is again perfected in some other way under this Act without an intermediate period when it was unperfected, the security interest shall be deemed to be perfected continuously for the purposes of this Act.

(2) *Assignee.*—An assignee of a security interest succeeds, in so far as its perfection is concerned, to the position of the assignor at the time of the assignment.

24. *Perfection by possession.*—Except as provided in sections 28 and 29, possession of the property by the secured party, or on his behalf by a person other than the debtor or the debtor's agent, perfects a security interest in—

(a) goods,

(b) an instrument, or

(c) a negotiable document of title,

but, subject to section 23, only so long as the secured party continues to be in possession of the property as such;

Provided that with reference to an instrument or a negotiable document of title, the requirements of any other applicable law relating to transfer or assignment of such an instrument or document of title shall also be complied with before a secured party can seek to enforce his perfected security interest in the instrument or negotiable document of title.

25. *Perfection by registration.*—A security interest in—

(a) goods,

(b) a general intangible, or

(c) any type of future property

is perfected by registration thereof and from the date of registration:

Provided that it shall be open to the debtor to apply, in the manner prescribed, to the authority, with whom the security interest is registered, for the revocation of the registration on the ground that the secured party has not given value in terms of the security agreement or has inordinately delayed the giving of such value.

26. *Security interest for purchase money in consumer goods.*—Notwithstanding anything contained in sections 24 and 25, a security interest for purchase money in consumer goods is perfected on the attachment of the security interest.

27. *Security interest in fixtures.*—Where goods, other than consumer goods, are intended to become, or have become, a fixture, registration, in accordance with sub-section (1) of section 45, of such security interest as applicable to a fixture is necessary to claim priority as a perfected security interest over any other security interest in the fixture.

28. *Temporary perfection by banks.*—(1) When the secured party is a bank and gives under a written security agreement value, not being an antecedent debt or liability, a security interest in an instrument or a negotiable document of title connected with such value shall be deemed to be perfected, without the taking of possession of the instrument or document, for a period of thirty days from the date on which the bank gives such value.

(2) A perfected security interest held by a bank in—

(a) an instrument which the secured party delivers to the debtor for the purpose of—

(i) ultimate sale or exchange, or

(ii) presentation, collection or renewal, or

(iii) registration of transfer; or

(b) a negotiable document of title or goods held by a bailee and not covered by a negotiable document of title, which document of title or goods the secured party makes available to the debtor for the purpose of—

(i) ultimate sale or exchange, or

(ii) loading, unloading, storing, transporting, shipping or transhipping, or

(iii) manufacturing, processing, packaging or otherwise dealing with the goods in a manner preliminary to their sale or exchange,

remains perfected for a period of thirty days after the property comes under the control of the debtor, but priority between conflicting security interests in the goods is subject to section 42.

(3) After the thirty day period referred to in sub-sections (1) and (2), perfection of the security interest is subject to compliance with the other provisions of this Act.

29. *Temporary perfection of security interest for purchase money in motor vehicles.*—(1) A security interest for purchase money which has attached to the chassis of a motor vehicle before a body is built

thereon shall be deemed to be perfected for a period of three months from the date of such attachment, and during this period the body built thereon shall be an addition to the property notwithstanding the provisions contained in section 46.

(2) After the said period of three months, perfection of the security interest is subject to compliance with the other provisions of this Act.

30. *Perfecting as to proceeds.*—A security interest in proceeds remains perfected if the interest in the original property was perfected, but it ceases to be a perfected security interest and becomes unperfected twentyone days after receipt of the proceeds by the debtor unless—

(a) the security interest is a registered one and the security agreement relating there to covers the original property and the proceeds therefrom ; or

(b) the security interest in the proceeds is otherwise perfected before the expiration of the twentyone day period ;

but there is no perfected security interest in proceeds that are not identifiable or traceable.

31. *Perfecting as to goods held by bailee.*—(1) A security interest in goods in the possession of a bailee who has issued, or to whom is addressed, a negotiable document of title covering them is perfected by perfecting a security interest in the document, and has priority over any other security interest in such goods perfected while the goods are so covered.

(2) A security interest in goods in the possession of a bailee, other than one who has issued a negotiable document of title therefor or to whom is addressed a negotiable document of title covering them is perfected when—

(a) the bailee issues a document of title in the name of the secured party ; or

(b) the bailee agrees in writing to hold the goods on behalf of the secured party.

32. *Goods returned or repossessed.*—(1) Where a security interest in goods was perfected by a registration at the time of the sale, lease or exchange of such goods, and the goods are returned to, or repossessed by, the person who sold, leased or exchanged them, the security interest reattaches on such goods as a perfected security interest.

(2) When a sale, lease or exchange of goods creates a general intangible which is assigned to a secured party and the goods are returned to or repossessed by any person specified in sub-section (1) of section 12, the security interest in the goods of the unpaid assignee of the general intangible will remain unperfected unless with reference to such goods the assignee of the general intangible perfects his security interest.

CHAPTER V

Effect of Perfection and Rules of Priority

33. *Subordination inter se of perfected and unperfected security interests.*—Subject to the other provisions of this Act, a perfected security interest has priority over an unperfected security interest in the same property.

34. *Priorities—General rule.*—(1) Subject to the other provisions of this Act, priority between security interests in the same property shall be determined—

(a) as amongst security interests which are perfected, by the order of time of perfection ; or

(b) as amongst security interests which have attached but are not perfected, by the order of time of attachment of the security interests.

(2) For the purposes of sub-section (1), a continuously perfected security interest shall be treated at all times as if perfected by registration if it was originally so perfected, and it shall be treated at all times as if perfected otherwise than by registration if it was originally perfected otherwise than by registration.

35. *Unperfected security interest.*—(1) The claims of a secured party having a security interest in the property are subordinate to—

(i) the claims of a subsequent purchaser of the property where the purchase was in good faith for value without knowledge of the unperfected security interest,

(ii) the claims of an unsecured creditor who, whether before or after the creation of an unperfected security interest, gets the property attached through judicial proceedings, and

(iii) the claims of the official assignee, receiver in insolvency or liquidator in a winding up,

unless, at the time when a claim arises under clause (i) or clause (ii) or clause (iii), he has a perfected security interest in the property.

(2) *Preference to bank regarding unperfected security interests.*—Notwithstanding anything contained in sub-section (1), the claims of a secured party who is a bank and who has attached in its favour an unperfected security interest rank in preference to the claims of the persons referred to in sub-section (1):

Provided that this sub-section shall not apply where the debtor is a company or where the property is a motor vehicle or a fixture or crops.

36. *Priority subject to agreement.*—A secured party may, by agreement, modify the priority of his security interest with reference to any other security interest, provided that such an agreement shall not operate to the prejudice of any person who is not a party to such agreement.

37. *Effect of registration of security interest in motor vehicles.*—Where a secured party, in good faith and for value, enters into a security agreement with a debtor regarding the property being a motor vehicle, the certificate of registration of which stands in the name of such debtor, and the security interest is registered, no other person claiming any interest in the vehicle shall be entitled to assert his claims in preference to the claims of such secured party.

A. EFFECT OF PERFECTION ON PURCHASERS

38. *Effect of perfection on buyer of goods in ordinary course of business.*—(1) Notwithstanding anything contained in section 35, a buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free from any perfected or unperfected security interest therein given by the seller or lessor whether or not the buyer or lessee knows of it unless he also actually knows that the sale or lease constitutes a breach of the security agreement.

(2) For the purposes of sub-section (1), the sale may be for cash or on credit and includes delivering goods or a document of title under a pre-existing contract of sale but does not include a transfer as security for or in total or partial satisfaction of a money debt or other obligation.

39. *Bona fide holder of negotiable instrument or document.*—Nothing in this Act shall affect the rights of a bona fide holder in due course of a negotiable instrument or of a holder who has obtained in good faith for value a negotiable document of title duly negotiated to him and any such holder takes priority over an earlier security interest even though perfected.

40. *Assignee of general intangible.*—The security interest of an assignee of a general intangible resulting from a sale, lease or exchange of goods is subordinate to a security interest under sub-section (1) of section 12 that was a perfected security interest when the goods became the subject of the sale, lease or exchange.

B. PRIORITY FOR SECURITY INTEREST FOR PURCHASE MONEY

41. *Security interest for purchase money.*—A security interest for purchase money that is perfected before or within ten days after the commencement of the debtor's possession of the property has priority over the interest of a transferee from the debtor under a transfer not in the ordinary course of business of the debtor occurring between attachment and perfection of the security interest.

42. *Security interest for purchase money in inventory.*—A perfected security interest for purchase money in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if—

(a) the security interest for purchase money is perfected at the time the debtor receives possession of the inventory ; and

(b) the person having a security interest for purchase money gives a notice in writing to the person having the conflicting security interest where the latter had registered his security interest covering the same types of inventory (i) before the date of the registration by the person having security interest for purchase money, or (ii) before the beginning of the thirty day period where the security interest for purchase money is temporarily perfected under sub-section (2) of section 28 ; and

(c) the holder of the conflicting security interest receives the notice before the debtor receives possession of the inventory ; and

(d) the notice states that the person giving the notice has, or expects to acquire, a security interest for purchase money in the inventory of the debtor, describing such inventory by item or type.

43. *Security interest for purchase money in other assets.*—A security interest for purchase money in the property or its proceeds, other than inventory, has priority over any other security interest in the same property if the security interest for purchase money was perfected at the time the debtor obtained possession of the property or within ten days thereafter.

C. CURRENT CROP LOANS BY BANKS

44. *Current crop loans by banks.*—Where a bank obtains a perfected security interest by registration in crops or their proceeds in respect of consideration given to enable the debtor to produce the crops and given not more than three months before the crops become growing crops by planting or otherwise, the bank has priority over any earlier perfected security interest, even though while giving the consideration the bank knew of the earlier security interest:

Provided that the period of three months specified above may be increased or reduced by rules for different areas of the country having regard to the nature of the crops, the seasonal and other local conditions.

D. FIXTURES

45. *Priority of security interest in fixtures.*—(1) Notwithstanding anything contained in section 43, a security interest that attached to goods before they became a fixture subsists and has priority as to the goods over the claims of any person who has an interest in the immovable property, provided the application for registration of such security interest as applicable to a fixture is made within a period of thirty days from the date the goods became a fixture, and such application contains a description of the land to which the goods have become a fixture.

(2) A perfected security interest in a fixture arising after the goods became a fixture, has priority over the claims of any person who subsequently acquired an interest in the immovable property, but not over any person who had a registered interest in the immovable property at the time the security interest attached to the fixture.

(3) The security interest in a fixture referred to in sub-section (2) is subordinate to the interest of a creditor with a prior registered encumbrance on the immovable property in respect of any subsequent advance made in accordance with section 79 of the Transfer of Property Act, 1882.

E. ACCESSIONS

46. *Accessions.*—(1) Subject to sub-section (2) and to section 47 and notwithstanding section 43.

(a) a security interest in goods which attaches before the goods become an accession takes priority as to the accession over the rights of any person having a claim on the principal goods to which accession is made; and

(b) a security interest in goods that attached after the goods became an accession has priority over the interest of any person who subsequently acquired a claim on the principal goods, but not against a person who had a claim on the principal goods on the date of attachment of the security interest in the accession.

(2) A security interest referred to in sub-section (1) is subordinate to the interest of a creditor with a prior perfected security interest in the principal goods to the extent that he makes any subsequent advance in accordance with section 14.

F. COMMINGLED GOODS

47. *Commingled goods.*—A perfected security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass, and, if more than one such security interest attaches to the product or mass, the security interests take effect according to the ratio that the cost of the goods to which the said interests originally attached bears to the cost of the total product or mass.

G. LIEN FOR SERVICES AND MATERIALS

48. *Priority of lien for services and materials.*—Where a person in the ordinary course of business renders services involving the exercise of skill in respect of the goods that are subject to a security interest, perfected or otherwise, or furnishes in the ordinary course of his business materials for the processing of such goods, he has with respect to such goods, in the absence of a contract to the contrary, priority over such security interest and a right to retain such goods until he receives remuneration for the services rendered or payment for the materials furnished.

CHAPTER VI

RIGHTS, OBLIGATIONS AND REMEDIES OF PARTIES

49. *Redemption of the property.*—At any time before the secured party has disposed of the property by sale or exchange or contracted for such disposition under section 64, the debtor, or any person other than the debtor who is the owner of the property, or any secured party other than the secured party in possession, may either —

(a) redeem the property by tendering fulfilment of all obligations secured by the property; or

(b) reinstate the security agreement by paying the sums actually in arrears, exclusive of the operation of any acceleration clause, or by curing any other default by reason whereof the secured party has become entitled to dispose of the property,

together with a sum equal to the reasonable expenses incurred for holding, repairing, processing, preparing the property for disposition and in arranging for its disposition, and, to the extent provided for in the security agreement, the reasonable legal expenses.

50. *Alienation of rights of debtor.*—The rights of a debtor in the property may be transferred notwithstanding a provision in the security agreement prohibiting a transfer or declaring a transfer to be a default, but no transfer prejudices the rights of the secured party including his right to treat a transfer in contravention of the security agreement as an act of default.

51. *Information from the secured party.*—(1) A debtor may, by a notice in writing, containing an address for reply and sent or delivered to the secured party at the address set forth in the security agreement, or at a more recent address if known, require the secured party to send or deliver to him at the said address—

(a) a statement in writing of the amount of the indebtedness and of the terms of payment thereof as on the date specified in the notice;

(b) a written approval or correction, as on the date specified in the notice, of the itemised list of the property attached to the notice;

(c) a written approval or correction, as on the date specified in the notice, of the amount of the indebtedness and of the terms of payment thereof; and

(d) a copy of the security agreement; or any one or more of the foregoing.

(2) The court may, on an application by a creditor or any other person having an interest in the property, direct the secured party to furnish the aforesaid information to any such party.

(3) The secured party is entitled to claim payment of any such charges as may be prescribed, before he is required to furnish such information.

52. *Waiver of rights by debtor.*—(1) Except to the extent provided in this Act, the requirements of the following provisions may

not be waived or varied in so far as they give rights to the debtor and impose duties on the secured party—

(i) the provisions in section 56 in so far as they require accounting for surplus proceeds of the property;

(ii) the provisions in section 64 dealing with the disposition of the property;

(iii) the provisions in section 49 dealing with the redemption of the property;

(iv) the provisions in section 67 dealing with the secured party's liability for failure to comply with the provisions of this Chapter; and

(v) the provisions in section 51 dealing with the information to be furnished by the secured party.

(2) Notwithstanding anything contained in sub-section (1), the parties may by agreement determine the standards by which the fulfilment of the rights and duties referred to in the said sub-section is to be measured if such standards are not manifestly unreasonable.

53. *Secured party not to proceed against the property exempt from attachment.*—Notwithstanding anything contained in this Chapter, the secured party's rights to proceed against the property shall not extend to the whole or any portion of the property in the possession of the debtor, which would otherwise be exempt under the provisions of any other law.

54. *Rights and duties of secured party regarding care of the property.*—(1) A secured party shall take such care in the custody and preservation of the property which is in his possession as is required of a bailee under sections 151 and 152 of the Indian Contract Act, 1872, and, unless otherwise agreed, in the case of an instrument, reasonable care includes taking necessary steps to preserve rights under the instrument against prior parties thereto.

(2) Unless otherwise agreed, where the property is in a secured party's possession—

(a) all necessary expenses incurred by him in respect of the possession or for the preservation of the property, including the cost of insurance and payment of taxes or other charges, are chargeable to the debtor and shall be secured by the property;

(b) the risk of loss or damage, except where caused by the negligence of the secured party, shall be on the debtor;

(c) the secured party may hold as an addition to the property any increase or profit, except money, received from the property, and he shall be entitled to apply forthwith any such money if received in reduction of the secured obligation; and

(d) the secured party shall keep the property identifiable, but fungibles may be commingled.

(3) A secured party may use or operate the property for the purpose of preserving the property or its value in the manner and extent provided for in the security agreement or in accordance with any order of the court.

(4) A secured party is liable for any loss or damage caused by his failure to meet any of the obligations imposed by this section, but does not, by reason only of such failure, lose his security interest.

55. *Banks and perfected security interest holders.*—(1) The rights and remedies under sections 58, 60, 61, 63 and 64 are available to all perfected security interest holders and to unperfected security interest holders who are banks.

(2) *Unperfected security interest holders.*—An unperfected security interest holder who is not a bank may proceed against the property only through court except with reference to collections on general intangibles and instruments pursuant to section 56.

56. *Secured party's rights over instruments and general intangibles.*—(1) A debtor may assign an instrument or a general intangible to a secured party under a security agreement; such an assignment may be with or without recourse to the debtor. Where such agreement does not expressly specify whether the assignment is with or without such recourse to the debtor, it shall be presumed to be an agreement with such recourse.

(2) Where such an agreement is without recourse to the debtor and in any event upon default, the secured party is entitled —

(a) to require the obligor on a general intangible to pay to the secured party further amount, if any, due from the obligor by giving him a notice in writing whether or not the assignor was theretofore making collections on the property; and

(b) to take over any proceeds to which the secured party is entitled.

(3) Where such an agreement is without recourse to the debtor and in any event upon default, a secured party is entitled to take steps

to collect the further amount, if any, due from the obligor and to take over any proceeds to which he is entitled, but the obligor may recognise the secured party's claims only subject to the provisions of any applicable law governing the assignment and payment.

(4) Where such an agreement is with recourse to the debtor and the assignee collects from the obligor on a general intangible or an instrument, he shall proceed in a reasonable manner and may deduct his reasonable expenses of collection.

(5) Where such an agreement is with recourse to the debtor and the secured party has dealt with the property under sub-section (4) or has disposed of it in accordance with section 64 or otherwise, he shall account for any surplus to any person, other than the debtor, whom the secured party knows to be the owner of the property, and, in the absence of such knowledge, he shall account to the debtor for any surplus.

(6) Where such an agreement is with recourse to the debtor, on the disposal of the property by the secured party in accordance with the provisions of this Chapter, the debtor shall be liable for any deficiency.

(7) Any payment in good faith, by an obligor on a general intangible or an instrument, to the debtor, or after he is notified of the assignment, to the assignee, shall be valid against any person claiming a security interest in respect of such general intangible or instrument.

Explanation.—For the purpose of this section, a security agreement without recourse means a security agreement which provides that the secured party cannot call upon the debtor to make good any deficiency in the debt after the secured party has realised the instrument or general intangible assigned to him.

57. *Remedies against goods and documents.*—The secured party may enforce the security interest by any method available in or permitted by law and, if the property is or includes a document of title, the secured party may proceed either as to the document of title or as to the goods covered thereby, and any method of enforcement that is available with respect to the document of title is also available *mutatis mutandis* with respect to the goods covered thereby.

58. *Secured party's right to take possession upon default.*—Upon default under a security agreement

(a) the secured party has the right to take possession of the property and for this purpose to enter the premises of the debtor.

In taking possession, the secured party may proceed without judicial process if this can be done without breach of peace or he may apply to the court for taking possession. If the security agreement so provides, the secured party may require the debtor to assemble the property and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both the parties; and

(b) if the security interest has been perfected by registration, the secured party may, while the goods are in the possession of the debtor, in a reasonable manner render the goods other than consumer goods or inventory temporarily unusable.

59. *Magistrate to assist banks in taking possession of the property.*—(1) A bank may request, in writing, the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, within whose jurisdiction the property is situate, or is found, to assist the bank in taking possession of the poperty or the document relating thereto in the case of a general intangible, and the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, as the case may be, shall, on such a request being made to him, assist the bank in taking possession of the property or the document relating thereto in the case of a general intangible.

(2) For the purpose of securing compliance with the provisions of sub-section (1), the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, as the case may be, may take or cause to be taken such steps and use or cause to be used such force as may, in his opinion, be necessary.

60. *Removal of accession.*—(1) Unless otherwise agreed, if a secured party, by virtue of section 46, has priority over the rights of any person having a security interest in the principal goods, he may, on default, subject to the other provisions of this Act, remove the property being the accession from the principal goods if he reimburses any encumbrancer or owner of the principal goods, who is not the debtor, for the cost of repairing any structural damage arising out of the removal of the property but not any diminution in value of the principal goods arising out of such removal; but a person so entitled to reimbursement may refuse permission for such removal until the secured party has given adequate security for any reimbursement arising under this sub-section.

(2) A person having a security interest in the principal goods that is sub-ordinate to a security interest by virtue of section 46 may, before or after the property has been removed by the secured party in accordance with sub-section (1), redeem the property upon payment to the

secured party of the amount owing under the security interest having priority over his claims.

61. *Removal of fixtures.*—(1) Unless otherwise agreed, if a secured party, by virtue of section 45, has priority over the claims of a person having an interest in the immovable property, he may on default, subject to the provisions of this Act respecting default, remove the property being the fixture from the immovable property if he reimburses any encumbrancer or owner of the immovable property, who is not the debtor, for the cost of repairing any structural damage arising out of the removal of the property but not any diminution in value of the immovable property arising out of such removal; but a person so entitled to reimbursement may refuse permission to remove the fixture until the secured party has given adequate secuity for any reimbursement arising under this sub-section:

Provided that any person having an interest in the immovable property may, subject to sub-section (2), avoid any removal in pursuance of this sub-section upon payment to the secured party of the amount owing under a security interest having priority over his claims.

(2) Notwithstanding anything contained in sub-section (1), the secured party shall not be entitled to remove the fixture from the immovable property to which it is affixed unless he has given to each person in whose favour there exists a registered interest in the land, a notice in writing of his intention to remove the fixture and unless each such person fails to pay the amount due and payable on the fixture within a period of twentyone days after the giving of the notice to him or within such longer period as the court may grant.

62. *Court's power to appoint a receiver.*—(1) Notwithstanding anything contained in this Act or in any other law for the time being in force, on the application of the secured party or the debtor or any other person having an interest in the property, the cohrt may appoint a receiver on such terms and conditions as it may specify if it considers such appointment just and necessary.

(2) A receiver appointed by the court under sub-section (1) shall be deemed to be a receiver appointed under Rule 1 of Order 40 of the Code of Civil Procedure and may exercise all such powers as may be conferred upon him under that Rule.

63. *Appointment of receiver.*—(1) Where under a security agreement a secured party is entitled to appoint a receiver of the property, and in any event upon default, the secured party may, at any time when he thinks it proper or necessary so to do, appoint, by writing

signed by him or on his behalf, a receiver of the property or any part thereof.

(2) Any person who has been named in the security agreement and is willing and able to act as receiver may be appointed by the secured party. If no person has been so named, or if all persons named are unable or unwilling to act, or are dead, the secured party may appoint any person to whose appointment the debtor agrees; failing such agreement, the secured party shall be entitled to apply to the court for the appointment of a receiver, and any person appointed by the court shall be deemed to have been duly appointed by the secured party. A vacancy in the office of receiver may be filled in accordance with the provisions of this sub-section.

(3) A receiver may at any time be removed by writing signed by or on behalf of the secured party and the debtor, or by the court on application made by either party and on due cause shown.

(4) A receiver appointed under the powers conferred by this section shall be deemed to be the agent of the debtor; and the debtor shall be solely responsible for the receiver's acts or defaults, unless the security agreement otherwise provides or unless such acts or defaults are due to the improper intervention of the secured party.

(5) The receiver shall have power to take possession of the property, to realise the whole or any part of it, to demand and recover all the income of the property, and for this purpose to proceed by way of suit, execution or otherwise in the name either of the debtor or of the secured party to the full extent of the interest which the debtor could exercise and to give valid receipts accordingly for the same and to exercise any other powers which may have been delegated to him by the secured party in accordance with the provisions of this section.

(6) Any person paying any money or delivering any property to the receiver shall not be concerned to inquire if the appointment of the receiver was valid or not.

(7) The receiver shall be entitled to retain and recover out of the property, for his remuneration, and in satisfaction of all costs, charges and expenses incurred by him as receiver, such commission as may be provided for in the security agreement and where it is not so provided, such sum as the court may think fit to allow, on an application made to it in this behalf.

(8) The receiver shall, if so directed in writing by the secured party or the debtor, insure to the extent, if any, to which the secured

party might have insured and keep insured the property or any part thereof being of an insurable nature.

(9) The receiver shall apply all money received by him, as follows, namely :—

(i) in discharge of taxes and out-goings whatever affecting the property;

(ii) in keeping down all sums or other payments, and the interest on all principal sums, having priority to the security interest in respect whereof he is receiver;

(iii) in payment of his commission, and of the premiums on insurances, if any, properly payable under the security agreement or under this Act, and the cost of necessary or proper repairs for the preservation of the property;

(iv) in payment of the interest falling due under the security agreement; and

(v) in or towards discharge of the principal money, if so directed in writing by the secured party;

and shall pay the residue, if any, of the money received by him and deliver the property, to the person who, but for the possession of the receiver, would have been entitled to receive the income and to have possession of the property.

(10) The provisions of sub-section (1) apply only if and as far as a contrary intention is not expressed in the security agreement; and the provisions of sub-sections (4) to (9) inclusive may be varied or extended by the security agreement, and, as so varied or extended, shall, as far as may be, operate in like manner and with all the like incidents, effects and consequences, as if such variations or extensions were contained in the said sub-sections.

(11) Application may be made to the court for its opinion, advice or direction on any present question respecting the management or administration of the property. A copy of such application shall be served upon, and the hearing thereof may be attended by, such of the persons interested in the application as the court may think fit.

(12) The cost of every application to the court under this section shall be in the discretion of the court.

64. *Secured party's right to dispose of the property upon default.*—(1) Upon default under a security agreement, the secured party may dispose of any of the property in its then condition or after any

reasonable repairing, processing or preparation for disposition, and the proceeds of the disposition shall be applied in the following order:—

(a) the reasonable expenses of holding, repairing, processing, preparing for disposition and disposing of the property and, to the extent provided for in the security agreement and not prohibited by law, any other reasonable expenses incurred by the secured party;

(b) the satisfaction of the obligation secured by the security interest of the party making the disposition; and

(c) the satisfaction of the obligation secured by any subordinate security interest in the property, if written demand therefor is received by the party making the disposition before the distribution of the proceeds is completed:

Provided that before satisfying the obligation of the subordinate security interest holder, the secured party shall give notice of such written demand to the debtor and if the debtor, within twentyone days from the date of receipt of the notice, expresses his objection to such satisfaction, the secured party shall deposit the surplus proceeds in court.

(2) *Proof of subordinate security interest.*—Where a written demand under clause (c) of sub-section (1) is received by the secured party, he may request the holder of the subordinate security interest to furnish him with reasonable proof of such holder's interest, and, unless such holder furnishes such proof within a reasonable time, the secured party need not comply with the demand of the subordinate security interest holder.

(3) *Disposal of the property without taking possession.*—A secured party being a bank and any person having a perfected security interest in the property may, upon default, dispose of the property without taking possession thereof.

(4) *Methods of disposition.*—The property may be disposed of in whole or in part, and any such disposition may be by public sale, private sale, lease or otherwise and, subject to sub-section (6), may be made at any time and place and on any terms so long as every aspect of the disposition is reasonable.

(5) *Secured party to dispose in reasonable time.*—The secured party shall dispose of the property in whole or in part within a reasonable time and may retain the property till then.

(6) *Notice of disposition.*—Unless the property is perishable or unless the secured party believes on reasonable grounds that the property will decline speedily in value, the secured party shall give to the debtor and to any other person who has a security interest in the property and who either has registered his security interest or is known by the secured party to have a security interest in the property, not less than fifteen days' notice in writing of his intention to dispose of the property. The notice shall contain:

(a) a brief description of the property;

(b) the amount required to satisfy the obligation secured by his security interest;

(c) the sums actually in arrears, exclusive of the operation of any acceleration clause in the security agreement, or a brief description of any other provisions of the security agreement for the breach of which the secured party intends to dispose of the property;

(d) the amount of the applicable expenses referred to in clause (a) of sub-section (1) or, in a case where the amount of such expenses has not been determined, his reasonable estimate thereof;

(e) a statement that upon payment of the amounts due under clauses (b) and (c) above the debtor may redeem the property;

(f) a statement that upon payment of the sums actually in arrears or the curing of any other default, as the case may be, together with the amounts due under clause (a) of sub-section (1) the debtor may reinstate the security agreement;

(g) a statement that unless the property is redeemed or the security agreement is reinstated the property will be disposed of and the debtor may be liable for any deficiency; and

(h) the date after which any public sale or private disposition of the property is to be made.

(7) *Service of notice.*—The notice required by sub-section (6) shall be sent by registered post acknowledgement due to the latest known postal address.

(8) *Secured party's right to purchase the property.*—The secured party may, with the permission of the court and subject to such conditions as the court may specify, purchase the property or any part thereof at a public sale.

(9) *Effect of disposition of the property.*—Where the property is disposed of in accordance with this section, the disposition discharges the security interest of the secured party making the disposition and, if such disposition is made to a bona fide purchaser for value, discharges also any subordinate security interest and terminates the debtor's interest in the property.

(10) *Purchaser's rights.*—A bona fide purchaser for value takes free of all such rights and interests even though the secured party fails to comply with the requirements of this Chapter, and in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale.

(11) *Certain transfers of the property.*—A person who is liable to a secured party under a guarantee, endorsement, covenant, repurchase agreement or the like and who receives a transfer of the property from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party, and such a transfer of the property is not a disposition of the property.

65. *Property in possession of a receiver.*—Where the property is in the possession of the official receiver or of a receiver appointed by any court, no proceedings under section 63 or under section 64 shall be taken except with the leave of the court concerned and otherwise than in accordance with such terms and conditions as such court may impose.

66. *Right of subrogation.*—Any subordinate security interest holder, any person interested in the immovable property to which a fixture is affixed or on which it is embedded, a person interested in the principal goods to which an accession is made, any person who has any interest in the property or any surety for the payment of the obligation secured, shall be entitled to redeem the property when the debtor who has the right to redeem does not exercise such right, and, on such redemption, shall have the same rights as the secured party, whose security interest he redeems, may have against the debtor or any other person having any security interest in the property.

67. *Secured party's failure to comply with this Chapter.*—(1) Where a secured party in possession of the property is not complying with an obligation imposed by section 54 or, after default, is not proceeding in accordance with this Chapter or the account is disputed, the debtor or any other person who is the owner of the property or the creditors of either of them or any person other than such secured party who has an interest in the property may apply to the court,

and the court may, upon hearing any such application, direct that the secured party comply with the obligations imposed by section 54 or that the property be or be not disposed of, or order an account to be taken or make such other or further order as the court deems just.

(2) If the disposition of the property has been made otherwise than in accordance with this Chapter, the debtor or any other person entitled to notice under sub-section (6) of section 64 or whose security interest has been made known to the secured party prior to the disposition has, without prejudice to sub-section (10) of section 64, a right to recover from the secured party any loss or damage caused by his failure to comply with this Chapter.

68. *Where agreement covers both immovable property and personal property.*—Where a security agreement covers both immovable property and personal property, the secured party may proceed under this Chapter as to the personal property and he may proceed as to the immovable property in accordance with his rights and remedies in respect of the immovable property.

69. *Other rights and remedies of the debtor and the secured party.*—(1) The debtor under a security agreement has the rights and remedies provided for in the security agreement and, in addition, the rights and remedies given to him under this Act.

(2) The secured party has the rights and remedies given to him under this Act and this shall be without prejudice to any other rights the secured party may have under the security agreement or otherwise.

70. *Rights and remedies cumulative.*—The rights and remedies referred to in this Chapter are cumulative.

71. *Determination of amount due.*—(1) Notwithstanding anything contained in any other law, where a secured party is a bank, either the debtor or the secured party may apply to the court for the determination of the amount due under the security agreement.

(2) On such application being made, the court may determine the amount due under the security agreement and thereupon it shall be open to the secured party to proceed against the property for recovery of the sum so determined, in accordance with the provisions of this Chapter.

72. *Appeals.*—Any provisions of law relating to appeals and revisions shall apply to any determination or order made under this Act as if such determination or order were—

(a) where it is made by a Registrar appointed under the Co-operative Societies Act of a State, an award made by such Registrar;

(b) where it is made by a court having jurisdiction under section 10 of the Companies Act, 1956, an order made by that court ; and

(c) where it is made by any other court, a decree passed by such court.

CHAPTER VII

REGISTRATION

73. *Mode of registration for perfecting a security interest.*—(1) Perfection of a security interest in the property by registration shall be—

(a) where the property is a motor vehicle, by registration under section 31A of the Motor Vehicles Act, 1939 ;

(b) where the property is a fixture or crops, by registration in accordance with Part III-A of the Registration Act, 1908 ;

(c) where the property is not a motor vehicle or a fixture or crops—

(i) where the debtor is a company, by registration under the provisions relating to "Registration of Charges" in the Companies Act, 1956 ; and

(ii) where the debtor is not a company, by registration in accordance with Part III-A of the Registration Act, 1908.

(2) Registration under clause (a) or (b) of sub-section (1) shall be without prejudice to, and shall be in addition to, the provisions of section 125 of the Companies Act, 1956.

74. *Registration under prior law.*—(1) Every security interest that has, prior to the coming into force of this Act, been recorded under the provisions of the Motor Vehicles Act, 1939, or registered under the provisions of the Companies Act, 1956, shall be deemed to have been registered and perfected under this Act.

(2) Every security interest relating to a fixture or crops that has been registered, under the provisions of the Registration Act, 1908, prior to the coming into force of this Act, along with or part of any security interest in the immovable property, in or to which the fixture is or is to be embedded or affixed or on which the crops are or are to be grown, shall be deemed to have been registered under the provisions relating to fixtures and crops under Part III-A of the Registration Act, 1908.

(3) Every security interest in the property, not being a fixture or crops or a motor vehicle, of the debtor who is not a company, if already covered by a security agreement registered under the Registration Act, 1908, prior to the coming into force of this Act, shall be deemed to have been registered under Part III-A of that Act for a period of ninety days from the date of coming into force of this Act. After the expiry of such period, the security interest shall not be regarded as so registered unless within this period the secured party applies to the Registrar having jurisdiction under Part III-A of the Registration Act, 1908, to enter the prescribed particulars relating to the earlier registration, in Book 6 to be maintained under that Act.

(4) On receipt of an application under sub-section (3), the Registrar shall give the debtor an opportunity of being heard in regard to the application, and unless the debtor satisfies him that the security interest no longer subsists, the Registrar shall enter the prescribed particulars relating to the earlier registration, in Book 6 to be maintained under the Registration Act, 1908:

Provided that no such opportunity need be given when the debtor has already given his consent in writing to the prescribed particulars being entered.

CHAPTER VIII

General Provisions

75. *Extension of time.*—(1) Where in this Act any time is prescribed within which or before which any act or thing must be done, the court on an application may, upon such terms and conditions and after notice to such persons, if any, as the court may order, extend the time for compliance.

(2) A copy of an order made under sub-section (1) shall, for the purposes of registration, be attached to the document to which the order relates. The rights or priorities which any other person may have at the time of the registration of the order made under this section are not affected by the order.

76. *Act governs security interest though not the obligation.*—The application of this Act to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Act does not apply.

77. *Conflicting provisions.*—Where there is a conflict between a provision of this Act and any other law for the time being in force, the provision of this Act shall prevail unless this Act provides otherwise.

78. *Reference to forms of security devices in other statutes.*—On and from coming into force of this Act, a reference in any statute or any rule, regulation or order made thereunder to a pledge, mortgage, hypothecation, floating charge, conditional sale, hire-purchase, or any other form of a transaction amounting in substance to the creation of a security interest in personal property shall be deemed to be a reference to such security interest (perfected or unperfected, as the case may be) under this Act.

79. *Amendments to other statutes.*—The provisions of the following Acts shall stand amended as indicated in the Schedules to this Act shown thereagainst, and each Schedule shall come into force from such date as the Central Government may, by notification in the Official Gazette, specify:—

(a)	The Indian Contract Act (Act IX of 1872) ...	First Schedule
(b)	The Transfer of Property Act (Act IV of 1882)	Second Schedule
(c)	The Sale of Goods Act (Act III of 1930) ...	Third Schedule
(d)	The Companies Act (Act I of 1956)	Fourth Schedule
(e)	The Registration Act (Act XVI of 1908) ...	Fifth Schedule
(f)	The Hire-Purchase Act (Act XXVI of 1972)	Sixth Schedule
(g)	The Motor Vehicles Act (Act IV of 1939) ...	Seventh Schedule
(h)	The Reserve Bank of India Act (Act II of 1934)	Eighth Schedule

80. *Government to frame rules.*—(1) For the purposes of carrying out the provisions of this Act, the Central Government may frame such rules as it may consider necessary from time to time.

(2) Without prejudice to the generality of the foregoing power, the rules may provide for—

(a) the prescribing of forms for use for the purpose of registration of any security interest, including the forms, registers and other records to be maintained by the authorities specified in section 73;

(b) the procedure and the formalities relating to the registration of security interests and the charges that may be levied for registration, issue of copies and the making of searches, etc., as the case may be, by the different authorities referred to in section 73;

(c) the prescribing of the duties of the authorities in relation to registration as specified in section 73 ;

(d) the specifying of the period under the proviso to section 44 ;

(e) the prescribing of the rate of charges which a debtor or any other person may be required to pay to the secured party for obtaining information under section 51 ;

(f) the prescribing of the period upto which books, documents, records and other papers relating to registration of a security interest shall be preserved by the respective authorities ;

(g) any other matter in respect of which the Central Government considers it necessary or advisable to frame rules to carry out effectively the intentions and purposes of this Act.

(3) Every rule made by the Central Government shall be laid, as soon as may be after it is made, before each House of Parliament while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification to the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be ; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

THE FIRST SCHEDULE

(*See* Section 79)

Amendments to The Indian Contract Act, 1872

1. The following shall be substituted for the existing section 173:

"173. *Rights and obligations of pawnors and pawnees.*—A pawnor shall have the same rights and obligations as a debtor has under the Personal Property Security Act, 1971 and a pawnee shall have the same rights and obligations as a secured party having possession of the personal property that is subject to a security interest has under the said Act."

2. Sections 174, 175, 176 and 177 shall be deleted.

THE SECOND SCHEDULE

(*See* Section 79)

Amendments to the Transfer of Property Act, 1882

1. The following shall be inserted as section 58A:

"58A. Nothing contained in this Chapter shall affect security interests over fixtures, to which the provisions of the Personal Property Security Act, 197-, are applicable."

2. In section 130, the following shall be substituted for the existing sub-section (2) :

"(2) The rights and remedies of the assignor and the assignee arising on the transfer of an actionable claim shall be the same as the rights and remedies available to the assignor and the assignee on the transfer of a general intangible under the Personal Property Security Act, 197 ."

3. Proviso to sub-section (1) of section 130 and sections 131 and 132 shall be deleted.

THE THIRD SCHEDULE

(*See* Section 79)

Amendments to the sale of Goods Act, 1930

In section 30—

(i) in sub-section (1), for the words "pledge or other disposition thereof" the words "or security agreement as defined in the Personal Property Security Act, 197-, relating to such goods or documents of title" shall be substituted ;

(ii) in sub-section (2), for the words "pledge or other disposition thereof" the words "or security agreement as defined in the Personal Property Security Act, 197-, relating to such goods or documents of title" shall be substituted ;

(iii) after sub-section (2) the following shall be added as sub-section (3), namely,

"(3) Nothing contained in sub-sections (1) and (2) shall affect the rights of a secured party having a perfected security interest in the goods or in the document of title to the goods under the provisions of the Personal Property Security Act, 197-."

THE FOURTH SCHEDULE

(*See* Section 79)

Amendments to the Companies Act, 1956

1. For the existing section 124, the following shall be substituted:

"124. *'Charge' to include mortgage in this Part.*—In this Part, the expression 'charge' includes—

(a) a mortgage of immovable property ; and

(b) a security interest in personal property including a fixture as defined in the Personal Property Security Act, 197 ."

2. In section 125, the following shall be inserted as clause (j) of sub-section (4):

"(j) charge on any other personal property of the company, except when it is perfected under the provisions of the Personal Property Security Act 197-, by possession or otherwise."

3. For section 126, the following shall be substituted:

"126. *Date of notice of charge.*—Where in respect of any charge on any property of a company required to be registered under section 125, a provisional entry has been made in pursuance of sub-section (1A) of section 130, any person acquiring thereafter such property or any part thereof, or any share or interest therein, shall be deemed to have notice of the charge as from the date of such entry."

4. In section 130, the following shall be inserted as sub-section (1A):

"(1A) Immediately on the filing of particulars under sub-section (1) of section 125, the Registrar shall make in the Register referred to in sub-section (1), a provisional entry showing that particulars have been filed with him under sub-section (1) of section 125, the nature of the transaction, the names, description and addresses of the parties thereto, and a description of the property to which the transaction relates."

5. In section 132, after the words "stating the amount thereby secured", the following shall be inserted:

"and specifying the date on which the particulars were entered on the Register of Charges as required by section 130".

THE FIFTH SCHEDULE

(*See* Section 79)

Amendments to the Registration Act, 1908

1. The following shall be inserted as Part III-A after Part III of the Act:

"PART III-A

Of Registration relating to the creation of Security Interests in Personal Property

22A. *Exclusions.*—Nothing contained in this Part shall be applicable to the registration of a security interest in the property, other than a fixture or crops, of a company as defined in the Companies Act, 1956, or over a vessel as defined under the Merchant Shipping Act, 1959, or over a motor vehicle as defined under the Motor Vehicles Act, 1939, or over an aircraft.

22B. *Place of registration.*—Registration of a security interest in personal property, other than a fixture or crops, may be effected only in the office of the Registrar in whose district the debtor ordinarily carries on business, or if he does not carry on business, where he ordinarily resides.

Explanation.—A debtor who has a Permanent Account Number for purposes of income-tax is deemed to carry on business at the place where he has the Permanent Account Number.

22C. *Procedure for registration.*—(1) An application for registration of a security interest in personal property, other than a fixture or crops, shall be executed, verified and authenticated in the manner prescribed and shall contain the following particulars:

(a) the name, description and address of the debtor;

(b) the name, description and address of the secured party;

(c) the date of execution of the security agreement;

(d) a description of the personal property sufficient to identity it;

(e) the amount secured under the security agreement; and

(f) such other particulars as may be prescribed.

(2) The Registrar shall enter the prescribed particulars as given in the application under sub-section (1) relating to the security interest, in Book 6 specified in section 51.

(3) After making the entry as required by sub-section (2), the Registrar shall issue a certificate of registration containing the prescribed particulars relating to the security interest and specifying the date on which the particulars were entered in Book 6 as provided by sub-section (2).

(4) For purposes of priority under the Personal Property Security Act, 197-, the registration shall take effect from the date specified in the certificate of registration as the date on which the particulars were entered in Book 6.

(5) Book 6 shall be open for inspection by any person on the payment of the prescribed fee.

22D. *Registration of security interests in fixtures or crops.*—(1) An application for the registration of a security interest in a fixture or crops shall be executed, verified and authenticated in the manner prescribed. Such registration shall be effected in the office of the sub-registrar within whose sub-district the immoveable property, in or to which the fixture is or is to be embedded or affixed or on which the crops are or are to be grown, is situate.

(2) An application for the registration of a security interest in a fixture or crops presented under sub-section (1) shall contain, in addition to the particulars specified in sub-section (1) of section 22C, a description, as required in sections 21 and 22 of the immovable property in or to which the fixture is or is to be embedded or affixed or on which the crops are or are to be grown.

(3) The sub-registrar shall enter the prescribed particulars as given in the application under sub-section (2) relating to the security interest, in Book 1 specified in section 51.

(4) After making the entry as required by sub-section (3), the sub-registrar shall issue a certificate of registration containing the prescribed particulars relating to the security interest and specifying the date on which the particulars were entered in Book 1, as provided by sub-section (3).

(5) For purposes of priority under the Personal Property Security Act, 197-, the registration shall take effect from the date specified in the certificate of registration as the date on which the partciulars were entered in Book 1.

22E. *Application for registration by post.*—(1) Notwithstanding anything contained in this Act, an application for registration of a security interest in personal property may be sent by registered post acknowledgement due.

(2) The Registrar or the sub-registrar, as the case may be after registration shall, if so desired by the applicant, send the certificate of registration by registered post acknowledgement due, at the cost of the applicant.

22F. *Provisions inapplicable.*—Without prejudice to generality of the provisions contained in this Part or of the Personal Property Security Act, 197-, Parts V to X (both inclusive) sections 52, 58, 59, 60, 61, 62, 64, 65 and 67 of Part XI, and Parts XII and XIII of this Act shall be inapplicable to the registration of a security interest in personal property including a fixture.

22G. *Meanings of certain expressions.*—In this Part and in section 51 the expressions "debtor", "fixtures", "personal property", "the property", "secured party", "security agreement" and "security interest" shall have the same meanings as they have under the Personal Property Security Act, 197-."

2. In section 51—

(a) in item A of sub-section (1) for—

'Book 1, "Register of non-testamentary documents relating to immovable property",'

the following shall be substituted:

'Book 1, "Register of non-testamentary documents relating to immovable property, fixatures and crops";'

(b) after entry 5 in item B of sub-section (1), the following shall be added:

'Book 6, "Register of security interests relating to personal property other than fixtures and crops".'

THE SIXTH SCHEDULE

(*See* section 79)

Amendment to the Hire-Purchase Act, 1972

For the existing section 31, the following shall be substituted:

"31. *Agreements to which this Act does not apply.*—This Act shall not apply to—

(a) any hire-purchase agreement made before the commencement of this Act;

(b) any hire-purchase agreement relating to a motor vehicle as defined in the Motor Vechiles Act, 1939;

(c) any hire-purchase agreement under which the hire-purchase price exceeds Rs. 25,000.

(d) any hire-purchase agreement which is made by or on behalf of a body corporate as the hirer of the goods to which the agreement relates; and

(e) any hire-purchase agreement in which the hirer is a dealer.

Explanation.—"Dealer" in this clause means any person who carries on the business of buying or selling the goods subject to a hire-purchase agreement."

THE SEVENTH SCHEDULE

(*See* section 79)

Amendments to the Motor Vehicles Act, 1939

1. For the existing clause 19 of section 2, the following shall be substituted:

"'Owner' means, where the person in possession of a motor vehicle is a minor, the guardian of such minor, and in relation to a motor vehicle which is the subject of a security agreement as defined in the Personal Property Security Act, 197-, the person in possession of the vehicle under that agreement."

2. After section 22, the following shall be inserted as section 22A :

"22A. *Meanings of certain expressions.*—For the purposes of this Chapter, the expressions "security agreement", "security interest" and "inventory" shall have the same meanings as they have under the Personal Property Security Act, 197-."

3. In section 24, the following shall be substituted for the existing proviso to sub-section (1) :

"Provided that where a motor vehicle is jointly owned by more than one person, the application shall be made by one of them on behalf of all the owners, and where the motor vehicle is owned by a firm, by one of the partners making his application in such capacity in either case, the applicant shall, for the purposes of this Act, be deemed to be the owner of the motor vehicle, and in the case of a motor vehicle owned by a firm, the certificate of registration shall indicate also the name of the firm."

4. In section 29, after sub-section (2), the following shall be added as sub-section (2A):

"(2A) The registering authority shall give to any person whose name is noted in the certificate of registration as the person entitled to a security interest in the motor vehicle, information regarding the assignment of fresh registration mark for the vehicle by sending to him a communication by registered post acknowledgement due at his address entered in the certificate of registration."

5. In section 30, after the words "original registering authority" occurring at the end of sub-section (2), the following shall be added:

"and to any person whose name is noted in the certificate of registration as the person entitled to a security interest in the motor vehicle."

For the existing section 31A, the following shall be substituted:

"31A. *Special provisions relatng to security interests in motor vehicles.* —(1) An application may be made in Form GA as set forth in the First Schedule, either at the time when an application for registration of a motor vehicle is made under sections 24 and 25 or at any other time, to the registering authority for the registration of a security interest in a motor vehicle.

(2) The application shall be accompanied by the certificate of registration, if any, relating to the motor vehicle.

(3) The registering authority shall enter the prescribed particulars relating to the security interest in the Register of Motor Vehicles and shall note in the certificate of registration the existence of the security interest in the prescribed manner.

(4) The Register of Motor Vehicles shall be open to inspection to any person on the payment of the prescribed fee.

(5) Anyone entering into any transaction relating to a motor vehicle shall be deemed to have notice of the security interest entered in the Register of Motor Vehicles and of the particulars noted in the certificate of registration pertaining to that motor vehicle.

(6) An entry made in the Register of Motor Vehicles and a note on the certificate of registration made under sub-section (3) may be cancelled by the registering authority on an application made in Form GB as set forth in the First Schedule.

(7) No entry regarding the transfer of ownership of any motor vehicle which is subject to a security agreement shall be made in the Register of Motor Vehicles or a certificate of registration except with the written consent of the person whose name appears in the Register of Motor Vehicles and the certificate of registration as a person entitled to a security interest in the motor vehicle.

(8) Where an application is made for the issue of a duplicate of a certificate of registration of a motor vehicle, the registering authority may grant such application only if the person whose name appears in the Register of Motor Vehicles as the person entitled to a security interest in the motor vehicle has expressed in writing his consent to the issue of the duplicate certificate of registration.

(9) Where a person whose name appears in the Register of Motor Vehicles and the certificate of registration as the person entitled to a security interest in the motor vehicle satisfies the registering authrity that, by reason of the default by the owner, he has become entitled to take possession of the motor vehicle and has done so, the registering authority may, after giving the owner (by sending to him a notice by registered post acknowledgement due at his address entered in the Register of Motor Vehicles or the certificate of registration) an opportunity to make such representation as he may wish to make and notwithstanding that the certificate of registration is not produced before it, cancel the certificate of registration and, on the payment of the prescribed fee, issue to such security interest holder a fresh certificate of registration showing him as the owner of the motor vehicle.

(10) At any time not more than one security interest may be registered in respect of a motor vehicle in pursuance of this section.

(11) This section shall not apply to a security interest in motor vehicles held as inventory."

7. In section 32—

(a) the following shall be inserted as the second proviso to sub-section (1):

"Provided further that the registering authority shall not give his approval without giving a reasonable opportunity to the person whose name appears in the Register of Motor Vehicles as a person entitled to a security interest in the vehicle to state his objections, if any, and without considering the objections, except where the said person has already consented to the proposed alteration."

(b) the following shall be inserted as the second proviso to sub-section (2):

"Provided further that the said time limit of seven days shall be read as thirty days in a case to which the second proviso to sub-section (1) applies, except where the person referred to in that proviso has already consented to the proposed alteration."

8. In the First Schedule to the Act, in Form E, the Note shall be deleted.

9. In the First Schedule to the Act, in Form G, for the existing Note, the following shall be substituted:

"NOTE.—The motor vehicle above described is held by the registered owner subject to a security interest in favour of.....

Date: Signature of the registering authority."

10. In the First Schedule to the Act, the following shall be inserted as Form GA :

"FORM GA

[*See* Section 31A(1)]

Form for the Registration of a Security Interest in a Motor Vehicle

1. Registered Number :
2. Brief description of vehicle :
3. Name of registered owner:
4. Date of creation of security interest :

Date: Signature of the registered owner.

Date : Signature of the security interest holder."

11. In the First Schedule to the Act, the following shall be inserted as Form GB:

"FORM GB

[*See* Section 31A(6)]

Form of the application for cancellation of entry/note regarding Security Interest

To

The Registering Authority,

.....

.....

We, the undersigned, hereby request that the entry in the Register of Motor Vehicles and the note on the certificate of registration, forwarded herewith, of vehicle No. ..... in respect of the security interest in the vehicle may be cancelled.

Date: Signature of the registered owner.

Date: Signature of the security interest holder."

THE EIGHTH SCHEDULE

(*See* section 79)

Amendment to the Reserve Bank of India Act, 1934

For the existing sub-clause (iii) of clause (c) of section 45I, the following shall be substituted:

"(iii) the providing of instalment credit whether in the form of hire-purchase agreement or otherwise for purposes that may be approved by the Bank in this behalf;"

EXPLANATORY NOTES ON THE CLAUSES OF THE PERSONAL PROPERTY SECURITY BILL, 197 .

Preamble

The Preamble sets out the scope of this Bill which is to reform the law regarding security interests in goods, fixtures, documents of title, instruments, actionable claims and other intangibles. The scheme of the Bill aims to encourage purpose and production-oriented credit, particularly by banks and other financing institutions in a manner that would enable them to purvey credit to the priority sectors and weaker sections of the society and help in the implementation of socio-economic programmes aimed to promote an integrated rural and urban economic development and of similar schemes aimed to facilitate and distribution of the material resources of the community so as to subserve the common good.

CHAPTER I

PRELIMINARY

This chapter deals with the short title, commencement, and the extent of the Bill and defines certain terms for the purposes of the Bill.

Short title, commencement and extent (Clause 1).—The Central Government is empowered to decide by notification the dates from which the different provisions of the Bill shall come into force. The President is empowered to notify, in consultation with the Government of the State of Jammu and Kashmir, the modifications, if any, subject to which this Bill shall extend to that State.

Definitions (Clause 2).—The definitions contained in the Bill give the scope of the expressions "security interest" (clause 2(xxxii)) and "security agreement" (clause 2(xxxi)). The definition of "security interest for purchase money" (clause 2(xxxiii), has been introduced in view of the special priorities given to purchase money security interests. The consideration for a security agreement may include "value" (clause 2(xxxiv)), which may be an antecedent debt or liability. The security interest may be enforceable against any "purchaser" (clause 2(xxvii)) claiming any "purchase" (clause 2(xxvi)) of the property. The expressions "registration", "registration of security agreement" and "registration of security interest" (clause 2(xxviii)) mean registration of the security interest in the property in accordance with Chapter VII of this Bill.

The expression "debtor" (clause 2(ix)) will include the owner of the property secured when the debtor is not the owner of the property, in any provision of the Bill dealing with the property, and the obligor, in any provision dealing with the obligation, and may include both when the context so requires. The debtor may be a "company" (clause 2(v)) which includes a foreign company, or a firm or a proprietary concern. The expression "creditor" (clause 2(viii)) will also include an assignee for the benefit of the creditors, a legal representative, an official assignee or a receiver or a liquidator. The expression "secured party" (clause 2(xxx)) will include also a person to whom a general intangible, e.g., an actionable claim or account receivable,

has been assigned or sold. The secured party will have the rights against "the property" (clause 2(xxv), or its "proceeds" (clause 2(xxiv), when there is "default" (clause 2(x)).

A security interest may relate to any "personal property" (clause 2(xxii)), which may also be "future property" (clause 2(xiv)), in "goods" (clause 2 (xvi)), or in a "fixture" (clause 2(xii)). or in an "accession" (clause 2(i)), or in a "document of title" (clause 2(xi)), or in an "instrument" (clause 2(xvii)) or in a "general intangible" (clause 2(xv)). The expression "goods" comprises only movable property including a fixture, growing crops, grass, and standing timber, "Consumer goods" (clause 2(vi)), "inventory" (clause 2 (xviii)), "fungible goods" (clause 2(xiii)) and "motor vehicle" (clause 2(xix)) are some of the categories of "goods" which are defined in view of the special treatment given to them with reference to security interests therein.

"Fungible goods" have been specially defined so as to facilitate bulk-storing of such goods and the extension of credit against these goods so warehoused.

"Fixture" has been given a special definition to cover machinery and other goods which are embedded in, or affixed to, earth and they are dealt with under the scheme of the Bill as personal property. The definition of "fixture" excludes "building" (clause 2(iii)) and "building materials" (clause 2(iv)).

"Instrument" is defined to cover "negotiable instrument" (clause 2(xxi)) including hundis and also securities which evidence a right to the payment of money and which in the ordinary course of business are transferred by delivery with any necessary endorsement or assignment. The expressions "document of title" and "negotiable document of title" (clause 2(xx)) have also been defined.

The expression "bank" (clause 2(ii)) would cover all commercial banks, co-operative banks, Reserve Bank of India, Industrial Development Bank of India and other term-lending institutions. Provision has been made for the Central Government notifying a hire-purchase financing institution accepting deposits from the public and any other financing institution to be regarded as "banks" under this definition.

The Registrar of Co-operative Societies where the creditor is a co-operative society, the company court where the debtor is a company and the creditor is not a co-operative society, and in other cases the civil court of competent jurisdiction would be the "court" (clause 2(vii)) under this Bill to go into the specified matters.

Government of India may "prescribe" (clause 2(xxiii)) "rules" (clause 2 (xxix)) for the purpose of carrying out the provisions of the Bill.

CHAPTER II

General Applicability

Application of the Bill (Clause 3).—The Bill would apply to every security agreement without regard to its form and without regard to the person who has title to the secured property. Transactions by way of lease which are intended as security and also transactions purporting to be a pledge, mort-

gage, hypothecation, floating charge, trust receipt, conditional sale or hire-purchase or purporting to postpone the passing of title until after the full payment of purchase price are also regarded as creating or providing for a security interest.

Where the Bill does not apply (Clause 4).—Statutory liens, rights of set-off, mortgage over ships and transactions governed by the Hire-Purchase Act, 1972, are not affected by the provisions of this Bill. But the scope of the Hire-Purchase Act, 1972, is excluded with reference to hire-purchase transactions specified under the proposed section 31 of that Act (Sixth Schedule to the Bill). With reference to hire-purchase agreements covering such transactions, this Bill would apply.

State legislation regarding money lenders and moneylending and legislation relating to pawnbrokers are also not affected by any provision of this Bill (Clause 5).

Clause 6 provides that, for the purpose of the Bill, any description of the property is sufficient if it reasonably identifies what is described.

CHAPTER III

General Effect of Security Agreement

Effectiveness of security agreement (Clause 7).—The security agreement is effective between the parties according to the terms they agree and also against the purchasers of the property, subject to the provisions of this Bill or of any other law.

The security interest attaches when value is given and the debtor gets rights in the property unless the parties intend to postpone the date of attachment. Clause 8 also clarifies when the debtor may be regarded as getting rights in specified type of property. For enforceability of a security interest, either the secured party shall be in possession of the secured property; otherwise, the debtor shall have signed a security agreement describing the property sufficiently (Clause 9). Clause 10 clarifies that for attachment of a security interest in a future property, no specific appropriation of the property towards the security interest is necessary.

Clause 11 states when future property shall be deemed to be taken for new value.

Clause 12 provides for a re-attachment of the original security interest in the goods returned or repossessed after they become the subject of sale, lease, or exchange. Clause 13 provides for the continuance of the security interest notwithstanding the sale, exchange or other disposition of the secured property. It also provides for the security interest continuing in any identifiable proceeds arising out of such disposition.

Clause 14 applies the rule now found in section 79 of the Transfer of Property Act, 1882, with reference to future advances under a security agreement covering personal property.

Clause 15 provides for a rule of commercial convenience and validates the practice whereby the debtor is allowed to use. commingle or dispose of all or any part of the secured property or the proceeds thereof.

Clause 16 affirms the secured party's right to create a charge on his interest in the secured property without impairing the debtor's right to redeem the property.

Clause 17 is intended to facilitate the assignment of accounts receivables by way of security by validating agreements entered into by the obligors with the sellers not to assert against the assgnees defences available against the sellers or lessors of the goods. Any claim to consumer goods is excluded so that this provision may not affect consumers' rights.

Clause 18 deals with the rights of an assignee of general intangibles or accounts receivables. These provisions enable the secured party, including a bank or any other financing institution, obtaining a security interest in accounts receivables either to follow the direct collection method or to allow the debtor to continue to collect the dues. The interest of the debtor under the accounts receivables is also protected as he is free to continue to pay to the assignor unless otherwise notified by the assignee. Good faith changes in executory contracts, the benefits of which are assigned, are permitted so long as the assignee's rights are not adversely affected.

Clause 19 expressly saves the application of the seller's conditions and warranties as specified in the Sale of Goods Act, 1930, where the seller retains the security interest for purchase money in goods.

Clause 20 declares that a security agreement purporting to create a security interest in any personal property shall be regarded only as an ordinary agreement for the purposes of the stamp law. Clause 21 provides that charges for registration of a security interest in a fixture or crops shall be the same as payable for the registration of an agreement relating to a movable property which is optionally registrable under Part III-A of the Registration Act, 1908 (as now proposed).

CHAPTER IV

PERFECTION

A security interest is perfected by registration or possession or by any provisions of the Bill which gives such security interest a perfected status either for a temporary period or otherwise.

Clause 22 provides that when all steps required for perfection are taken in whatever order they are taken, the security interest is perfected provided it has attached.

Where perfection is otherwise than by registration and steps therefor have been taken before attachment of the security interest, the interest is perfected when it attaches.

Clause 23 provides for the continuity of perfection where perfection is claimed under more than one method available for perfection under the Bill and there has been no intervening period of time when the interest remained unperfected.

Clause 24 provides for perfection of a security interest in goods, instruments or negotiable documents of title by the secured party taking possession of the same.

Clause 25 provides for perfection of a security interest in goods, general intangibles or accounts receivables or any type of future property by means of registration. While registration of a security interest perfects the interest from the date of such registration, the debtor is allowed to show that the interest has not attached for non-payment of value by the secured party and hence is not so perfected.

Thus, while a security interest in goods can be perfected either by possession or registration, that in an instrument or a negotiable document of title can be perfected only by means of possession and not registration. Again, a security interest in a general intangible can be perfected only by registration.

Clause 26 gives a perfected status to a purchase money security interest in consumer goods on its attachment without the necessity for any further steps. Consumer goods are those used or acquired by a debtor, being an individual, for his personal, family or household purposes and they do not, as defined, cover motor vehicles.

Clause 27 provides that registration of a security interest as applicable to a fixture is necessary for claiming perfection and priority when goods, other than consumer goods, become a fixture. A time limit of 30 days is allowed for such registration from the date the goods become a fixture.

Clause 28 provides for temporary perfection of a security interest in favour of a bank. This provision is meant to enable banks and other financing institutions to give trust receipt facilities and packing credit facilities which are vital for the development of the country's export and import trade, on a wider scale than they have been allowed so far.

Several expert bodies have recommended special legislation to enhance the status of trust receipts and this question has been under consideration for the past several decades since the Indian Central Banking Enquiry Committee (1931) made its report. Clause 28 and other related provisions would now effectively fulfil this long-felt need.

Clause 29 provides for a temporary perfection of a security interest obtained for giving purchase money in motor vehicles. In the road transport industry, chassis is acquired with instalment credit from a financier (a bank or a hire-purchase financing institution) and additional finance is required for building a body thereon as per specifications. The additional finance would normally be provided by the institution which has given an instalment credit for obtaining the chassis, and during the interregnum the instalment credit financier's interests have to be properly protected. Clause 29 gives a perfected status for a period of three months for purchase money security interest which has attached to a chassis of a motor vehicle before a body is built thereon.

Clause 30 lays down the rules as to perfection when security interest is claimed in the proceeds of goods.

Clause 31 deals with perfection of a security interest as regards goods held by a bailee, e.g. a warehouseman or a carrier. When a negotiable document of title is issued covering such goods, perfecting a security interest in such a document of title also perfects a security interest in the goods. When there is no negotiable document of title covering the goods, perfection of the

security interest takes place when the bailee issues a document of title in the name of the secured party or agrees in writing to hold the goods on behalf of the secured party.

Clause 32 deals with the perfection of a security interest in returned or repossessed goods.

CHAPTER V

Effect of Perfection and Rules of Priority

The general effect of the rules as to priority is stated in clauses 33 and 34. When all security interests in a secured property are perfected, priority is determined by the order of time of perfection. Amongst the security interests which have attached but are not perfected, priority depends by the order of time of attachment of the security interests. A perfected security interest has priority over an unperfected security interest in the same property.

Clause 35 indicates the effect on the security interest by reason of subsequent purchasers of the secured property, the claims of unsecured creditors who through judicial process acquire a lien on the property by attachment or the like, and the claims of an official assignee or receiver in insolvency or a liquidator in a winding up. An unperfected security interest acquired by a secured party other than a bank has no priority over such claims.

However, where the debtor is not a company and the property is not a motor vehicle or a fixture or crops, the claims of a secured party which is a bank and which has attached in its favour the security interest in the property rank in preference to the claims of subsequent purchasers, unsecured creditors and the claims of an official assignee or receiver. This preference is given to banks with reference to their advances to non-company borrowers and against assets with reference to which the machinery for registration of security interests will take time to be adequately strengthened. In other words, it covers bank advances to firms and proprietary concerns, small artisans and other small business people availing themselves of production and purpose-oriented bank credit. This should help banks in adequately extending finance to small business people in rural areas and also extending credit to self-employed.

Clause 36 gives the liberty to a secured party to modify by agreement the priority as regards his security interest without prejudicially affecting the interests of any person who is not a party to such an agreement.

Clause 37 protects the persons who enter into transactions as regards motor vehicles in good faith and for value with debtors in whose favour the certificates of registration of the vehicles stand.

Clause 38 protects a buyer in the ordinary course of business of goods sold or leased by a person dealing in the ordinary course of his business.

Clause 39 clarifies that nothing in the Bill shall affect the rights of a bona fide holder in due course of a negotiable instrument or of a holder who has obtained in good faith for value a negotiable document of title.

Clause 40 deals with a security interest of an assignee of a general intangible (e.g., account receivable) resulting in a sale, lease or exchange of goods.

Clauses 41 to 43 state the special rules as to priority of security interest for purchase money. Purchase money security interest has special significance and merits encouragement for the economic development of the nation.

Clause 41 preserves the perfected status of a security interest for purchase money from the date the security interest attaches for a period of ten days after the debtor obtains possession of the property. This period is necessary to enable the purchase money secured creditor to take adequate steps to register or otherwise perfect his security interest.

Clause 42 provides for a priority for purchase money secured creditor when he finances the acquisition of an inventory of a merchant or trader. In order that earlier security interests in the inventory of such merchant or trader are not affected, conditions have been prescribed, namely, for such earlier security interest holders being duly notified and for the purchase money secured creditor registering his security interest within the time allowed.

Clause 43 provides for the preference to purchase money secured creditor of assets other than inventories. Here also a period of ten days is allowed during which time the purchase money secured creditor is deemed to have a perfected interest and in the interregnum he may by registration or otherwise perfect his interest.

Clause 44 states a special rule of preference as regards advances by banks for raising current crops. Current crop loans have a special economic significance and the bank giving such credit should be adequately safeguarded. By giving priority in respect of the current crops that may be raised with the finance, this provision may, to a considerable extent, obviate the determination of a vexed question as to whether or not, under the tenancy or other local laws applicable, the cultivator has an interest in the land sufficient to enable him to create a security interest therein for obtaining the necessary credit for cultivation.

Clause 45 deals with fixtures. Registration as a fixture is necessary to claim a perfected status for a security interest in a fixture. The claims of any person having an interest in the immovable property will not affect the interest of a fixture charge holder, if the interest in the immovable property arises subsequent to the goods becoming a fixture. But the interest of the person having an encumbrance on the immovable property is protected with reference to subsequent advances made by him under section 79 of the Transfer of Property Act, 1882. Clause 46 states the rules as regards security interests in accessions. When costly parts are supplied to valuable machinery on credit, these rules will cover the situation. The rules for reconciliation of security interests as regards the claims of a person having an interest in the accession and one having an interest in the principal goods are similar to those applicable with reference to the claims of a person having a security interest in a fixture as opposed to the claims of a person having a security interest in the immovable property.

Clause 47 deals with perfected security interests in goods which are commingled in such a way that their identity is lost. In the final product, the security interests take effect according to the ratio the cost of the goods, to which the said interests originally attached, bears to the cost of the total product or mass.

Clause 48 states the rules as to priority in respect of the interest of a person who has rendered services or furnished materials in the ordinary course of his business, with reference to the goods which are subject to a security interest, perfected or otherwise. For such services rendered or materials furnished, the supplier has a priority over the security interest and a right to retain the goods until he receives remuneration. The principle underlying this provision is already recognised in other statutes where claims arising on account of services rendered or work done rank in preference to the claims of other creditors of the concerned debtor.

CHAPTER VI

Rights, Obligations and Remedies of Parties

In setting out the rights and remedies on default, the Bill makes a distinction between rights and remedies of secured parties who are having perfected security interest, i.e., those who might have taken special steps to give public notice of their interests in the secured property which is in the debtor's hand and those who are having only unperfected security interests in the secured property. The latter would not have taken steps to give public notice of their security interests and hence certain special rights and remedies are made available only to the former.

But banks are given a special position as opposed to other classes of lenders, mainly the money-lenders. Though an unperfected security interest of a bank does not give the bank a greater priority, the bank is allowed the same rights and remedies as are available to those having perfected security interests.

Clause 49 deals with the debtor's rights in the redemption of the property.

Clause 50 expressly gives the debtor the right to transfer his rights in the secured property but gives the liberty to the secured party to treat such a transfer, if prohibited by the security agreement, as an act of default.

Clause 51 gives the debtor a right to obtain from the secured party sufficient details of the secured property and the amount of indebtedness by giving the secured party a notice in writing.

Clause 52 places certain rights of the debtor under the Bill beyond the scope of any waiver by him. These rights relate to the secured party's obligations to account for surplus proceeds when the property is an instrument or a general intangible, his disposition of the property, the debtor's rights to redeem the property, the debtor's right to approach the court for the secured party's failure and the secured party's obligation to furnish information regarding the security and the indebtedness.

Clause 53 saves from the provision relating to enforcement of the property which would be exempt from attachment under the provisions of the Code of Civil Procedure. This provision is intended to save weaker and poorer sections of the society from undue harassment.

Clause 54 gives the rights and duties of the secured party regarding the care he has to take of the secured property in his possession.

Clause 55 specifies the special rights, namely, the right to take possession of the secured property upon default, the right to remove fixture or accessions, the right to appoint a receiver, and the right to dispose of the property on default, which are available to perfected security interest holders and to banks, whether or not the concerned bank's security interest is perfected.

An unperfected security interest holder, who is not a bank, may proceed only through court except with reference to collections on general intangibles (e.g., accounts receivables) and instruments.

Clause 56 states the provisions necessary for enforcing the secured party's rights when the secured property is an intangible like an account receivable or is an instrument. It recognises the commercial practice whereunder either the indirect or the direct collection method is followed. In the former method the obligor on the intangible is not notified of the assignment and the debtor continues to collect from his obligors. This provision also states the rules to be applied to determine whether an assignment of an intangible is to be considered as one for security or is an absolute one. The former is presumed unless the security agreement provides otherwise. The liability of the secured party to account for the surplus or claim the deficiency from the debtor arises when the assignment is not absolute and is regarded only by way of security. In such a case, the secured party is also obliged to proceed in a commercially reasonable manner in enforcing direct collection. Until the obligor to the debtor is notified of the assignment, payments by the obligor made bona fide and in good faith are also protected.

Clause 57 gives to the secured party the liberty to proceed against the goods or documents of title covering such goods, where the security interest covers both.

Clause 58 deals with the procedure for the secured party exercising his right to take possession of the property upon default.

Clause 59 is a special provision which enables banks to seek the help of the magistrate to take possession of the property in the event of default. This special provision is considered necessary in public interest and in the view that banks may contribute to economic development effectively if prompt repayment of their dues is ensured and for this, the banks' security is suitably safeguarded. This provision is analogous to section 45S of the Banking Regulation Act, 1949, but is somewhat restrictive in that the action of the magistrate is not placed beyond the pale of judicial review.

Clause 60 provides for the removal of an accession by the secured party from the principal goods when there is a default.

Clause 61 provides for the removal by the secured party of the fixture from the immovable property to or in which it is attached or embedded.

Clause 62 expressly confers on the court the right to appoint a receiver on terms and conditions which the court may consider as just and necessary.

Clause 63 gives the right to the secured party to appoint a receiver in the event of default, if such right is conceded in the security agreement.

Clause 64 sets out the secured party's right to dispose of the property upon default. Unless the property is perishable or declines speedily in value, the secured party is required to give reasonable notice of such disposition. On such disposition, a bona fide purchaser takes free of the rights and interests of the debtor and of any subordinate security interest holder in the property.

Clause 65 states that the leave of the court has to be obtained for any proceedings under clause 63 or clause 64 of this Bill when the property is in the possession of the receiver.

Clause 66 provides for the right of subrogation for any subordinate security interest holder when the debtor does not exercise his right to redeem the property.

Clause 67 gives the liberty to the debtor to seek a remedy when the secured party fails to comply with any obligation imposed on him under the Bill with reference to the secured property.

Clause 68 deals with composite security agreement where both personal property as defined in this Bill and immovable property are subject to the security agreement. The secured party is given the right to proceed under this Bill as regards his rights in the personal property and he may proceed as per law against the immovable property in accordance with his rights over such property.

Clause 69 saves the collateral rights which the debtor or a secured party may have under the security agreement and which are not contravening any other provisions of this Bill.

Clause 70 states that the rights and remedies under this Chapter of the Bill are cumulative.

Clause 71 provides a summary method for determination of amount due under the security agreement when it is disputed, in cases where the secured party is a bank. The secured party may avail himself of this procedure without being obliged to enforce the secured property through court. He may exercise his rights to proceed against the property without the intervention of the court for the amount which may be judicially determined as due under the security agreement.

Clause 72 provides for the application of the provisions relating to appeals and revisions against orders made by the Registrar of Co-operative Societies, or a company court or any other court.

CHAPTER VII

REGISTRATION

The different authorities now attending to recording or registration of security interests in personal property are under this Bill brought under one comprehensive scheme. These authorities are the Sub-Registrars and the

Registrars functioning under the Registration Act, 1908, the Registrars of Companies functioning under the Companies Act, 1956, and the regional transport authorities functioning under the Motor Vehicles Act, 1939. Special provisions have been made to strengthen the role of these authorities in the process of registration of security interests in personal property.

Clause 73 states the required steps for perfection by means of registration of any security interest in personal property. This step, when the secured property is a motor vehicle, will be registration under section 31A of the Motor Vehicles Act, 1939, and it will be registration under Part III-A of the Registration Act, 1908, when the security interest is in a fixture or crops. With reference to other forms of personal property, if the debtor is a company, registration will have to be in accordance with the provisions for registration of charges under the Companies Act, 1956, and where the debtor is not a company, registration may be effected in accordance with Part III-A of the Registration Act, 1908.

Where the debtor is a company, and the secured property is a motor vehicle or a fixture or crops, registration under the Companies Act, 1956, will also be necessary in order that the security interest may be enforceable against the liquidator or third parties.

Clause 74 states the provisions necessary for dealing with security interests created before the coming into force of this Bill.

CHAPTER VIII

General Provisions

Clause 75 gives the court the right to extend the time limits specified in this Bill under its various provisions. Clause 76 makes this Bill govern any security interest, though the obligation giving rise to such security interest may have arisen pursuant to a transaction or interest to which this Bill does not apply. Clause 77 makes a provision of this Bill applicable when it conflicts with a provision of any other law.

Clause 78 deals with the meaning to be given after the coming into force of this Bill, to references to the different forms of security devices in vogue in other statutes. Clause 79 deals with the date for the coming into force of the amendments proposed under Schedule I to Schedule VIII. Clause 80 gives the Government of India the power to frame rules that may be necessary from time to time to give effect to the objectives and provisions of this Bill. These rules shall be laid before each House of Parliament for a total period of thirty days.

THE FOURTH SCHEDULE

Amendments to the Companies Act, 1956

The amendments proposed to the Companies Act, 1956, are mainly consequential to the coming into force of this Bill.

The occasion is also made use of to require the Registrars of Companies to make immediately a provisional entry in the Register of Charges of the particulars relating to registration of charges, pending their registration.

THE FIFTH SCHEDULE

Amendments to the Registration Act, 1908

A new Part is proposed to be added (Part III-A) which will deal with registration relating to the creation of security interests in personal property.

Under the proposed Part III-A, security interests in fixtures and current crops would require to be registered with the Sub-Registrar of Assurances under whose jurisdiction the immovable property or the agricultural land is situate.

Security interests obtained in the assets of firms, proprietary concerns and other small business people are proposed to be registered with the Registrar in any registration district. Such registration shall be effected with the Registrar within whose jurisdiction the debtor ordinarily carries on business or ordinarily resides. A debtor who has a Permanent Account Number for the purposes of income-tax is deemed to carry on business at the place where he has the Permanent Account Number.

Special proyision has also been made for sending applications for registration of security interests either to the Registrar or the Sub-Registrar, as the case may be, by post, and also for the certificate of registration being sent by the said authorities by post.

THE SEVENTH SCHEDULE

Amendments to the Motor Vehicles Act, 1939

The certificate of registration is given a greater recognition as a document of title under this Bill. The register now maintained by the motor vehicles authorities is being given statutory recognition. Section 31A of the Motor Vehicles Act, 1939, has now been recast to be consistent with the scheme of this Bill.

Certain other changes have also been made in the Motor Vehicles Act, 1939, having regard to the difficulties faced by banks and other financing

institutions in the working of the provisions relating to the registration of security interests in the register maintained by the motor vehicles authorities, in the certificate of registration, and with reference to enforcement of such securtiy interests.

THE SECOND SCHEDULE

Amendments to the Transfer of Property Act, 1882

The Transfer of Property Act, 1882, is proposed to be amended consequent upon the adoption of the statutory scheme with reference to security interests in personal property. Overlapping provisions dealing with actionable claims in Chapter VIII of the Transfer of Property Act, 1882, have been deleted.

THE FIRST SCHEDULE

Amendments to the Indian Contract Act, 1872

The changes proposed to the Indian Contract Act, 1872, are consequential. The provisions with reference to pledge found in sections 174, 175, 176 and 177 are proposed to be deleted as they have become redundant.

THE THIRD SCHEDULE

Amendments to the Sale of Goods Act, 1930

Section 30 of the Sale of Goods Act, 1930, deals with a sale, pledge, or other disposition of the goods when the vendor continues in possession after the passing of the title, or when the buyer obtains possession before he gets title. Amendments have been suggested to section 30 consequent upon the coming into force of a statutory scheme to deal with personal property security interests.

THE SIXTH SCHEDULE

Amendment to the Hire-Purchase Act, 1972

Consequent upon the coming into force of the statutory scheme to deal with security interests in personal property without regard to the form of the security device and without undue emphasis on the location of title to the goods, necessary changes have been proposed to the Hire-Purchase Act, 1972, which has not yet been brought into force. From the scope of the Hire-Purchase Act, 1972, it is intended to exclude transactions which may not be regarded as consumer credit. Hire-purchase agreements relating to motor vehicles, hire-purchase agreements under which the hire-purchase price exceeds Rs. 25,000/-,

or where such agreements are made by or on behalf of a body corporate as the hirer of the goods, or where with reference to such agreements the hirer is a person carrying on the business of buying or selling, are the types of transactions which would hereafter be governed by this legislation and not by the Hire-Purchase Act, 1972.

THE EIGHTH SCHEDULE

Amendment to the Reserve Bank of India Act, 1934

The reference to hire-purchase financing institutions in the definition of "financial institutions" in section 45I is being recast to cover all forms of hire-purchase agreements whereunder instalment credit is provided.

ANNEXURES


सत्यमेव जयते

ANNEXURE 1

THE NATIONAL CITY BANK OF NEW YORK

Incorporated with limited liability under the National Bank Act of the United States of America—Established 1812

Bombay : December 26, 1952

In replying please quote initials: MGT.

MEMORANDUM SUBMITTED TO THE RESERVE BANK OF INDIA BY THE NATIONAL CITY BANK OF NEW YORK, BOMBAY, ON TRUST RECEIPTS AND THE NEED FOR ENACTING TRUST RECEIPTS ACT IN INDIA

Until certain decisions of some of the Indian High Courts and especially the Calcutta High Court were given, Trust Receipts discharged a very useful function in banking practice in India. When a banker had to part with bills of lading or goods without receiving the amount due from the customer, it was the practice to obtain a trust receipt signed by the customer agreeing to hold the goods or their sale proceeds in trust for the banker, so long as the entire amount due to the banker was not paid off. If a customer who had signed such a trust receipt failed to hand over to the banker the sale proceeds of the goods sold, the customer was considered liable to be prosecuted for criminal breach of trust.

However, a decision of the Madras High Court in regard to trust receipts in a case in which the Central Bank of India Ltd. had instituted criminal prosecution against two groundnut exporters in Madras "almost stunned the banking community in India", to quote the words of Mr. M. L. Tannan, late Principal and Professor of Banking, Sydenham College of Commerce and Economics, Bombay, and a Member of the All-India Industrial Tribunal (Bank Disputes) from his book on "Banking Law and Practice in India".

The faith of Bankers in Trust Receipts was further shaken and the utility of Trust Receipts was practically nullified by three decisions of the Calcutta High Court reported in I.L.R. 56 Cal. 1074 (in re. Nripendra Kumar Bose); I.L.R. 59 Cal. 818 (in re: Summermull Singana); and I.L.R. 60 Cal. 262 (The Chartered Bank of India v/s The Imperial Bank of India).

Mr. Tannan in his above mentioned book has pointed out that "the legal position as to trust receipts will continue to be regulated by the Calcutta decisions until reversed, and consequently from the banker's point of view trust receipts may be considered valueless".

The Central Banking Enquiry Committee (1931) in para 565 of their report recommended that "the legal position as regards this matter (i.e. trust receipts) may be investigated by the legal advisers of Government and such action taken as may be considered necessary".

The recommended action has not yet been taken and hence the law as to Trust Receipts remains in a very unsatisfactory state upto now. Hence this Memorandum is being submitted to the Reserve Bank of India in the hope that the Reserve Bank of India will be pleased to move the Government of India to undertake suitable legislation to restore to Trust Receipts in some measure the efficacy and the utility which they commanded prior to the above mentioned decisions.

"Fundamentally a trust receipt is aimed at combination of a businessman's conscience and the equity powers of a court". (Ward & Harfield, "Bank Credits and Acceptances in International and Domestic Trade", Ronald Press, 3d. Ed., p. 76). One holding title to, or title documents covering merchandise, surrenders possession of the documents and the underlying merchandise or of the merchandise itself upon a written undertaking of the person receiving possession to the effect that title shall remain in the entruster and that the trustee will redeliver either the merchandise or their proceeds. Few problems are raised by use of a trust receipt device so long as the entruster and the trustee are involved; the instrument effectively binds the trustee and his obligation will be enforced against him by a court. But very real and intricate problems arise when third-party interests intervene, as for example, creditors and/or bonafide purchasers from the trustee.

"In the United States of America also Trust Receipts appear to have undergone similar vicissitudes as in India but there legislation supervened as soon as the need for it was felt. The trust receipt operated in the United States originally as a common law device, but it was said that after some fifty years of this development the trust receipt was so swaddled in juristic chaos as to make legislation imperative (Commissioner's prefatory note to the Uniform Trust Receipts Act, 9 Unif. Laws Anno. 666). Accordingly, the National Conference of Commissioners on Uniform State Laws, roughly 20 years ago, proposed legislation which would have the effect of clarifying the uncertainties then inherent in the use of the Trust Receipt. The Uniform Trust Receipts Act was first adopted by New York in 1934 (New York Personal Property Law Sections 50-58-1), and has subsequently been adopted without material deviation in 28 additional jurisdictions of the United States. The Act regulates not only the orthodox importing trust receipt transactions, but the analogous domestic transaction." It also regulates and validates the use of a trust receipt in favour of a pledgee where the pledgor-dealer happens already to have acquired title. On the other hand, it delimits the range of the transaction covered so as to prevent substitution of the relative informality of the trust receipt transaction for the ordinary chattel mortgage. The trust receipt may cover the release of goods or documents to dealers, the release of negotiable securities to depositaries or brokers, release of commercial paper to a pledgor for collection or renewal, but its purpose is always expressly limited and any transaction falling outside the purpose expressed in the statute is not protected by the Act. In general, it accepts the desirability of protecting the new financing of a dealers incoming stock (or release of security to a pledgor) while allowing possession to be in the dealer (or pledgor of securities) for a legitimate purpose looking toward realization or substitution of the security. It proceeds on the theory that the entruster is entitled to protection only against honest insolvency of the trustee. Accordingly bonafide purchasers are protected against the entruster (with certain limitations) and the entruster assumes the risk of dishonesty of the trustee. The Act provides for constructive notice to the public by means of filing, and for a reasonable period of validity even without filing. This period may vary according to the type of transaction.

In general, the Act is intended to work to the interest of Trust Receipt financiers by freeing their transactions of unnecessary and perplexing formalities, by clearly defining their rights, by simplifying their problems of proof in the event that the trustee becomes insolvent and by clarifying and making efficient the procedures which they must follow in order to foreclose on property or proceeds. It is intended to work to the interest of trust receipt borrowers by limiting their obligations to the writing, by cheapening their financing, by increasing the realization of security on a foreclosure and by increasing the marketability of their assets by protecting purchasers.

Because the Trust Receipts Act is deliberately drawn to cover a relatively narrow area, it excludes the normal chattel mortgage or conditional sales transaction, and further has no application to a bailment which does not specifically come within the area covered by the Act.

As indicated above, the Trust Receipts Act has been in effect in New York for 18 years and without substantial change is in effect in a total of twenty-nine jurisdictions. While it may be less than perfect, it has demonstrated its practical workability.

It is therefore submitted that legislation on the lines of the abovementioned Uniform Trust Receipts Act now in force in the United States of America may be recommended by the Reserve Bank of India to be undertaken by the Government of India at an early date, so that the present unsatisfactory status of Trust Receipts may be rectified and Trust Receipts which discharge a useful and important function in banking practice may once again acquire their former efficacy.

For THE NATIONAL CITY BANK OF NEW YORK,

Sd/- .....

Sub-Manager.

ANNEXURE 2

BANKING LAWS COMMITTEE

(Government of India)

Review of Legislation Affecting Banking

*QUESTIONNAIRE ON THE LAW RELATING TO LOANS AND ADVANCES BY BANKS AND OTHER FINANCIAL INSTITUTIONS

While the general law relating to loans and advances by banks and other financial institutions is found mainly in the Contract Act, the Transfer of Property Act, the Stamp Act, the Registration Act and the English Common Law as applied in India, there are special provisions applicable to co-operative societies, companies and some statutory financial corporations. It is necessary that for the development of the credit system of the country, the laws as to loans and advances by financial institutions have to be simple, certain, flexible and capable of being adapted to the growing needs of the society. Hence, the law has to be reviewed having regard to the needs of the changing times and the developments in other advanced countries. To facilitate such review, the following Parts of the questionnaire have been framed with reference to the provisions of the aforesaid enactments and the law in certain other countries, especially U.K. and U.S.A.

@PART 13—LOANS AND ADVANCES BY BANKS—GENERAL

Group 1—Vis-a-vis the law in other countries

13.1.1 Do you consider it necessary or desirable that the law in India relating to loans and advances by banking and other allied institutions should, as far as possible, be in line with the law in other developed countries ?

13.1.2 Article 9* of the Uniform Commercial Code (UCC) of the United States of America sets out, in a codified form, a comprehensive scheme for the regulation of security interests in personal property and fixtures. But there is no such statutory scheme in India. Do you consider it necessary or desirable to have a similar statutory scheme in India ?

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*The questionnaire was originally issued by the Banking Commission's Study Group which reviewed legislation affecting banking.

@Parts 5, 6, 11, 12, 14, 15 and 18 to 21 of the questionnaire relate to other branches of laws under review by the Banking Laws Committee. Parts 7 to 10 of the questionnaire relate to the Revision of the Negotiable Instruments Law, on which the Banking Laws Committee has already submitted its Report to the Government of India in February 1975.

*Some of the salient features of Article 9 of the UCC are referred to in Parts 16 and 17 of the questionnaire.

13.1.3 The Agricultural Credits Act, 1928@ of U.K. contains special provisions for an easy and simple method of creation of charges in favour of banks in relation to their advances to the agricultural sector.

(a) Do you consider it necessary or desirable to have such special statutory provisions in favour of banks in India ? If so, would you like to have similar provisions applied in relation to all classes of banks ? Or, would you confine such provisions to any class of banks ?

(b) Do you consider that such special provisions should apply in relation to all types of advances by such banks or that they should be confined only to particular types of advances, such as advances to agricultural sector, small-scale industries, etc. ? If you favour the latter, please indicate the types of advances in relation to which such special provisions could be applied.

(c) Do you also consider it necessary or desirable that such special provisions should be available only in relation to advances by banks up to a specified sum ? If so, please indicate the limit.

Group 2—Special provisions relating to financial institutions

13.2.1 The co-operative credit societies and the land development banks have the benefit of special provisions** relating to creation of the charge, enforcement thereof, recovery of dues, etc.

(a) Do you consider that generally it is necessary or desirable to have similar provisions applied in relation to other classes of banks ? If not, would you favour their extension only to a class or classes of them; in which case, please specify.

(b) Do you favour the application of such special provisions in relation to all types of advances by such banks or do you regard that they should be confined to particular types of their advances, such as advances to the agricultural sector, small-scale industries, etc. ? If you favour the latter, please indicate the types of advances in relation to which such special provisions could be applied.

(c) Do you consider it necessary or desirable that such special provisions should be available only in relation to loans and advances up to a specified sum ? If so, please indicate the limit.

13.2.2 The Industrial Finance Corporation Act and the State Financial Corporations Act have special provisions for facilitating the expeditious enforcement of their claims against the borrowers.

(a) Do you consider it necessary or desirable to have similar provisions applied also in relation to all classes of banks generally ? If not, would you favour their extension to some of them ; in which case, please specify them.

@Some of the salient features of the Agricultural Credits Act, 1928 of U.K. are referred to in Parts 16 and 17 of the questionnaire.

**Some of the salient features of the Co-operative Societies enactments are referred to in Parts 14, 15 and 16 of the questionnaire.

(b) Do you favour the application of such special provisions in relation to all types of advances by such banks or do you regard that they should be confined to particular types of advances, such as advances to the agricultural sector, small-scale industries, etc.? If you favour the latter, please indicate the types of advances in relation to which such special provisions could be applied.

(c) Do you consider it necessary or desirable that such special provisions should be available only in relation to loans and advances up to a specified sum? If so, please indicate the limit.

PART 16—CHARGE ON MOVABLE ASSETS

Group 1—GENERAL

16.1.1 Please state the difficulties, if any, in obtaining movable assets as security for loans and advances. Do you consider that the law in relation thereto requires any modification? If so, please indicate the lines on which such modifications may be desired.

16.1.2 The law as regards taking moveables as security (except as regards pledges) has no statutory basis and rests on the Common Law of U.K. as judicially interpreted in India. Are you in favour of codifying the law as regards taking movable assets as security for loans and advances?

16.1.3 In U.S.A., Article 9* of the UCC has codified the law as to taking of moveables as security. Are you in favour of any legislation in India on those lines?

Group 2—Hypothecation—Nature of

16.2.1 Do you regard the hypothecation over the movable assets of their borrowers obtained by banks in India as creating in their favour only an "equitable charge" over the relative assets? Please give your views with reasons.

[*vide* (1935) A.C. 53 at 64]

16.2.2 If you regard the hypothecation document obtained by banks as conferring in their favour only an "equitable charge", do you agree that as the law in India recognises no distinction between legal and equitable estates, such "equitable charge" confers in favour of banks only personal rights and as such conveys no interest in property?

[*vide* Mulla's Transfer of Property Act, 5th Edition, page 51]

Group 3—Hypothecation and future advances

16.3.1 Do you consider that at present it is legally necessary to specify the limit in relation to future advances up to which moveable assets offered as security can be a valid cover? If so, would you like to suggest any change to this position?

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*Some of the salient features of Article 9 are dealt with in the questions that follow.

16.3.2 In U.S.A., it is not necessary to indicate a ceiling limit up to which future advances could be secured against the security of moveables. Do you favour a provision on these lines ? If not generally, at least in relation to advances by banks and financial institutions ?

[*vide* section 9-204(5) of the UCC]

Group 4—Hypothecation—After acquired property

16.4.1 Do you experience any difficulty in relation to hypothecation documents covering also after acquired property ? Would you like to have the position clarified in India ?

[*vide* in re Ambrose Summers, I.L.R. 23 Cal. 592]

16.4.2 In U.S.A., a charge over specified types of movable assets by way of security could cover also such types of after acquired properties of the borrower. Are you in favour of a similar provision in India ?

[*vide* section 9-204 of the UCC]

16.4.3 In U.S.A., a lender cannot obtain a security interest in the after acquired property of the borrower when the security relates to future crops coming into existance one year after the agreement creating the charge, unless such security is offered in conjunction with the interest in the land and is to last only so long as such interest last. Do you consider that provision on these lines is desirable in India in relation to hypothecation of crops ?

[*vide* section 9-204(4)(a) of the UCC]

Group 5—Hypothecation—Enforceability against third parties

16.5.1 Hypothecation over movable assets obtained by banks is not enforceable against third parties dealing with such assets without notice of the transaction. What steps are taken to notify third parties of the hypothecatees' interest in such assets ? Do you consider that such steps are effective ? If not, would you suggest any measures to safeguard the interests of the lending institution ?

16.5.2 In relation to hypothecated assets of companies, registration of the banks' charge with the Registrar of Companies constitutes notice of the charge to third parties dealing with such assets. Hence, in relation to such charges, are any precautions, other than registration, taken to notify third parties of the charge ?

16.5.3 The provision in the Companies Act, 1956, providing for registration of the hypothecation in favour of banks with the Registrar of Companies enables companies to effectively create a charge over their stock-in-trade at low cost. Do you consider that it is necessary or desirable to have a similar provision with reference also to borrowers other than companies ?

16.5.4 If you feel so, what measures you would suggest to ensure that hypothecation charge in favour of banks over the assets of borrowers other than companies are known to third parties dealing with the assets ?

16.5.5 Article 9 of the UCC provides a scheme for registration, with a common authority, of charges over the movable assets of all types of borrowers. Do you consider that it would be necessary or desirable to provide for a scheme of registration of hypthecation charges over the assets of all types of borrowers, including companies, with an authority to be constituted in this regard ? If so, what type of machinery you would envisage for this purpose ?

16.5.6 Under the Bills of Sales Acts of U.K., assignment of moveables, other than documents of title to goods, is ordinarily required to be registered. On similar lines do you feel it desirable to provide for registration of mortgages over moveables in India ?

16.5.7 Both under Article 9 of the UCC and the Bills of Sales Acts of U.K., an assignment, by way of security, of moveables has to be by a written instrument. Do you feel that it is necessary or desirable to provide so in India ?

16.5.8 If you are in favour of providing for a scheme of registration in relation to hypothecation or mortgage of movable assets, would you like to exempt from such a scheme transactions below a particular amount ? If so, please indicate the limit.

Group 6—Hypothecation—Enforceability against Official Assignee/Receiver

16.6.1 Do you consider that at present, on the insolvency of the borrower, the banker has a preferential claim for his dues against the hypothecated assets in the possession of the borrower ? Would you like to clarify the position ? If so, how would you like to ?

[*vide* I.L.R. 3 Cal. 58; 1895 A.C. 56;

I.L.R. 23 Cal. 592 and A.I.R. 1932 Cal. 680]

16.6.2 In U.K., a letter of hypothecation (synonymous with trust receipt) in favour of the banker takes the relative goods out of the purview of the reputed ownership clause in bankruptcy. Do you consider that the position in India should also be the same or different ?

[*vide* in re Hamilton Young, 1905 (2) K.B. 381]

16.6.3 It is said that the reputed ownership clause in insolvency law will not apply to goods in the possession of the borrower and hypothecated to the bank provided the bank has taken such steps as displaying its name-board, posting its watchmen, etc. on the premises where the goods are kept. Do you consider that the position in this regard is sufficiently clear ? If not, would you like to provide that on such steps having been taken by the banker, the preferential claim of the banker shall not be affected by reason of the reputed ownership clause on the insolvency of the borrower ?

16.6.4 If you are in favour of such a provision, what steps you would expect a banker or a lending institution to take for excluding the relative goods from the operation of the reputed ownership clause ?

16.6.5 It has been felt that the doctrine of reputed ownership is a serious invasion on the rights of the owner and the tendency of the courts in England has been to limit its application within narrow limits. Please give your views on the same.

16.6.6 Would you like to exclude from the scope of the reputed ownership clause the hypothecated assets of borrowers? If not generally, at least in relation to hypothecation in favour of banks and financial institutions?

16.6.7 Do you consider that the reputed ownership clause has any application in relation to winding up of companies?

[*vide* section 529 of the Companies Act, 1956]

16.6.8 In any event, do you consider that the hypothecated assets of companies would go out of the reach of the reputed ownership clause provided the relative hypothecation has been duly registered with the Registrar of Companies?

16.6.9 Do you consider that if hypothecation of assets of all types of borrowers could be registered with a public authority, the interest of the lender would be adequately protected on the insolvency of the borrower?

Group 7—Hypothecation—Motor vehicles

16.7.1 Have you noticed any difficulty in enforcement of a charge in favour of the lending institution over motor vehicles? If so, please state them with your suggestions, if any, for remedying the same.

16.7.2 In all the States, do the existing rules and enactments relating to motor vehicles permit the noting, in the registration certificate, of the charge in favour of the lender against the vehicles? If not, would you suggest any specific provision therefor?

[*Vide* section 31A introduced by the Motor Vehicles Amendment Act, 1969]

16.7.3 In U.S.A.* a charge against a motor vehicle, trailer or any equipment or accessories fixed or shown to be fixed thereto is not valid against persons not having notice thereof unless and until the charge is registered in the registration certificate of the vehicles. Do you consider that a provision on these lines is necessary or desirable in India to safeguard the interests of the lending institutions and third parties dealing with motor vehicles?

16.7.4 In U.S.A.* any charge or lien in relation to a motor vehicle is also indicated in a register maintained by an official, which is available to the public for inspection. Do you consider it desirable or necessary to have similar provisions in India with reference to charges over motor vehicles?

16.7.5 In U.S.A.* the person having the first charge in relation to a motor vehicle has the right of claiming possession of the registration certificate. Do you consider it necessary or desirable to statutorily provide in India for such a right in favour of the lending institutions?

Group 8—Hypothecation—Stamp duty

16.8.1 Generally, hypothecation documents are subjected to stamp duty as mortgage of moveables; but, the duty on attested instruments evidencing agreements relating to hypothecation is reduced to the duty

**Vide* Chapter 7, Title 40 of the District of Columbia Code, 1967 Edition.

leviable on agreements relating to deposit of title deeds, pawn or pledge, while the duty on such unattested instruments is remitted. Do you consider that the reductions and the remissions in relation to hypothecation documents are adequate in all the States? If not, please give your suggestions in this behalf.

16.8.2 While duty on unattested hypothecation documents over assets other than crops is generally remitted, duty on hypothecation document covering crops is on an *ad valorem* basis. Do you consider that in the interest of facilitating advances to the agricultural sector, it is necessary or desirable to remit the duty payable on instruments evidencing hypothecation of crops?

Group 9—Hypothecation—Priorities

16.9.1 As between persons claiming the same asset as security, on what basis you would like to determine the order of priority? Would you like this to be on the basis of the date of creation of the charge or the date on which possession is taken pursuant to the charge, or the date on which action is initiated on the charge? If there is a provision for registration and the charges are registered, how would you like to determine priorities?

[*vide* A.I.R. 1932 Cal. 524; (1935) 62 Cal. 1046; and 1933 (40) C.W.N. 625]

16.9.2 In U.S.A., ordinarily the priorities between conflicting claims over the same asset as security are decided in the following order:

(a) in the order of registration if both the conflicting claims are registered;

(b) the registered claim in preference to the unregistered one, irrespective of the date of creation of the charge;

(c) in the order of creation of the charge when both the conflicting claims are not registered.

Would you generally favour a provision on the aforesaid lines to settle the rules as regards priority in India?

[*vide* section 9-312(5) of the UCC]

16.9.3 In U.S.A., charges in relation to the following types of advances are ordinarily given a special preference over other types of charges in the same asset:

(a) finance towards current crop production—in relation to such crops.

(b) financing the acquisition of stock-in-trade or other asset—in relation to such stock-in-trade or other asset.

(c) financing the acquisition of replacements of parts etc. of machinery or other goods (accessions)—in relation to such accessions as against a claim on the machinery or other goods.

Do you consider that it is necessary or desirable to provide in India for such preferential claim in relation to such types of financing?

16.9.4 Do you consider that under the following circumstances, the interest of the first hypothecatee is protected:

(a) a subsequent hypothecatee taking possession of the hypothecated asset either with or without notice of the earlier hypothecation [*vide* (1871) 3 N.W.P. 54; (1871) 3 N.W.P. 71; and (1866) 5 W.R. 189]?

(b) the borrower pledging the hypothecated goods with another person who has or has not notice of the earlier hypothecation [*vide* 1918 (42) Mad. 59; 1929 (56) Cal. 868; 25 Mad. 406; (1874) No. 70 Punj. Rec. 223; and 10 I. and C. 869]?

(c) when a subsequent pledgee sells the hypothecated asset [*vide* 1920 (1) Lahore 422; 1924 (47) M.L.J. 704; 1927 (5) Rangoon 633 and 1887 (10) Allahabad 20]?

(d) when the subsequent hypothecatee comes to the court first [*vide* 1933 (40) C.W.N. 625]?

(e) when any person subsequently obtains with or without notice a legal mortgage over the goods covered by the earlier hypothecation agreement in favour of the bank?

Do you consider that the first hypothecatee's interests are not adequately protected in all or any of the above cases; if you do, please indicate what statutory provision need be made to safeguard his interests?

Group 10—Hypothecation—Proceeds

16.10.1 Do you consider that at present the hypothecatee has a valid claim to the sale proceeds of the goods hypothecated to him? If not, do you consider it necessary or desirable to recognise such claim?

[*vide* I.L.R. 5 Mad. 330]

16.10.2 In U.S.A., the lender's claim over the secured asset could cover also any identifiable proceeds (which may be cash proceeds or non-cash proceeds) thereof including collections received by the borrower. Do you consider it necessary or desirable to provide so in India?

[*vide* section 9-306 of the UCC]

16.10.3 In U.S.A., the lender's claim ordinarily continues notwithstanding the sale, exchange or other disposition by the debtor of the secured asset, unless disposition is authorised by the lender. Do you favour such a position in India?

[*vide* section 9-306 of the UCC]

16.10.4 In U.S.A., when the secured goods have become part of a product or mass, the interest of the lender is continued in such product or mass even if the identity of the secured asset is lost in the course of manufacturing, processing, assembling or mingling them. The extent of the lender's interest is determined on the ratio of the cost of the secured asset to the cost of the total product or mass. Do you consider it necessary or desirable that a hypothecatee's interest need be

preserved also when the identity of the asset is lost in the course of such manufacture, etc. ? If so, would you favour the UCC position ?

[*vide* section 9-315 of the UCC]

Group 11—Hypothecation—Rights of a hypothecatee

16.11.1 Do you consider that the rights of the hypothecatee in the event of default are adequate to preserve and enforce his claim against the hypothecated asset ?

16.11.2 It is said that the effect of hypothecation obtained by banks gives them only a right of realisation by judicial process in case of non-payment of the debt. Do you agree ? If so, do you consider that in the interest of the lending institution and to make hypothecation a more acceptable form for advances by banks, the hypothecatee should be given any further rights in relation to such asset ?

16.11.3 In the event of the borrower defaulting, have you noticed any difficulties in getting possession of the hypothecated assets ? If so, please state them and give your suggestions regarding them.

16.11.4 Where the borrower refuses to part with possession, but possession is nevertheless taken by the creditor, do you consider that the hypothecatee has the right of private sale in relation to the goods as a pledgee ? Do you consider that it is necessary or desirable to clarify the position ?

[*vide* section 148 of the Indian Contract Act and sections 2(2) and 66(3) of the Indian Sale of Goods Act]

16.11.5 In U.S.A., in respect of secured asset in the hands of the borrower, the lender has the following rights when the borrower defaults:

(a) the right of foreclosure or judicial sale ;

(b) the right of direct collection of intangible assets like book debts. negotiable instruments and documents of title to goods ;

(c) the right to take possession of the secured assets and obtain control over any proceeds to which the security interest extends—this could be without judicial process if this can be done without breach of peace ; if not, by judicial action ;

(d) the right to sell, lease or otherwise dispose of any or all of the security in its then condition or following any commercially reasonable preparation or processing—this could be done (except in the case of negotiable instruments or documents of title to goods) even when the assets are lying in the debtor's premises, provided the disposal is as per reasonable commercial standards ;

(e) the right to appropriate the security in satisfaction of the dues when the borrower and others having interest therein do not object to such appropriation within a specified time.

(The rights are cumulative and are not in the alternative).

Do you consider that it would be desirable or necessary to provide in India for such remedies in favour of the lender in relation to hypothecation charges ?

16.11.6 Do you consider that at present the hypothecatee has any right to "accessions" of the hypothecated assets? If not, do you consider it necessary or desirable to give such rights to the hypothecatee?

Group 12—Floating charge over moveables—Nature of

16.12.1 In U.K., a floating charge is defined as "an equitable charge on the assets for the time being of a going concern". Do you regard a floating charge in India as creating an "equitable charge" or a "legal charge"?

[*vide* 1897 A.C. 81 at 86]

16.12.2 If you consider a floating charge as conferring only an "equitable charge" in favour of the lender, do you regard that in India by the creation of such a charge a lender would get an interest in property or only personal rights enforceable against the immediate parties and others dealing with the property with notice thereof?

[*vide* Mulla's Transfer of Property Act, 5th Edition, page 51]

Group 13—Floating charge—How determined

16.13.1* How do you obtain a floating charge over the movable assets of the borrower for advances?

**(To be answered by banks and financial institutions)*

16.13.2 It has been stated that floating charge is created when—

(i) the assets charged are both present and future;

(ii) the assets are in a state of flux; and

(iii) the borrower is allowed to carry on business in such assets in the ordinary way until some step is taken by the floating charge holder.

Do you agree that a document containing the above provisions would create a floating charge?

[*vide* 1888 (13) A.C. 520; 1897 A.C. 81; 1904 A.C. 355 and 1910 (2) K.B. 979.]

16.13.3 Do you regard the hypothecation obtained by banks in India over the stock-in-trade of the borrower as creating in their favour only a floating charge?

[*vide* also 1926 (50) Bom. 547; and 1926 (54) Cal. 513]

Group 14—Floating charge—Companies and others

16.14.1 Do you consider that it is legally permissible to create floating charges over the assets of borrowers other than companies? Are you aware of the creation of such charge?

16.14.2 If a floating charge is only an "equitable charge" in India and confers only personal rights, and it is enforceable only against those having notice thereof, do you consider that there is an impediment in floating charge being obtained over the assets of borrowers other than companies?

16.14.3 Do you consider that floating charge obtained by banks over the assets of borrowers who are companies is more secure by reason of the provision as to registration? If so, would you consider that to make the floating charge an acceptable form of security also in relation to borrowers other than companies, it is desirable to provide for a scheme of registration of such floating charge?

Group 15—Floating charge—Agricultural Credits Act, 1928 of U.K.

16.15.1 In U.K., a cultivating farmer is statutorily enabled, *inter alia*, to create in favour of a bank a floating charge in respect of his farming stock and other agricultural assets as security for his obligations to the bank. Do you consider it necessary or desirable to so statutorily provide in India?

16.15.2 In U.K., after a floating charge is so created, any fixed charge on, or a bill of sale comprising any of, the property comprised in the floating charge, is void so long as the floating charge is in force. Do you consider that it would be conducive to the financing of agriculture by banks if there could be a similar provision in India?

16.15.3 In U.K., such a floating charge is specifically excluded from the operation of the reputed ownership clause on the insolvency of the borrower. Do you consider that it is necessary or desirable to have similar provision in India?

16.15.4 In U.K., all agricultural charges, including floating charges, are required to be registered with the Land Registrar. Such registration constitutes notice to all persons and for all purposes connected with the property comprised in the charge. Do you consider that provisions on similar lines would be necessary or desirable in India?

Group 16—Floating charge—Registration

16.16.1 It has been suggested that the Registration Act should be amended to provide for registration of floating charges with the Sub-Registrar in Book I (which is available for inspection by public). Do you consider it necessary or desirable?

Group 17—Pledge—Documents of title to goods

16.17.1 Do you consider that there is any difficulty in India for borrowers creating a pledge on their goods by pledging the documents of title relating thereto?

[*vide* Morvi Mercantile Bank's case, A.I.R. 1965 S.C. 1954]

16.17.2 By reason of receipts issued by carriers for carriage of goods, like truck receipts, not qualifying as documents of title to goods, it is felt that banks are not in a position to advance against the goods covered by the relative documents by the pledge of such documents. Have you any suggestions to facilitate the pledge of such goods by lodging the relative document as security?

[*vide* A.I.R. 1968 Mysore 133]

Group 18—Pledge—Shares

16.18.1 It is felt that the distinction between pledge and mortgage of shares is not clear and gives rise to avoidable litigation. How do you like

to make a distinction between these? Or would you prefer to statutorily provide for the rights of parties when advances are made against the security of shares?

[*vide* A.I.R. 1956 Patna 32; and A.I.R. 1960 A.P. 273]

16.18.2 Do you consider that ordinarily a pledgee of shares should have his claim extended also to cover the dividend, rights and bonus shares issued in respect of the shares originally pledged?

[*vide* A.I.R. 1969 Delhi 313]

Group 19—Pledge—Stock-in-trade

16.19.1 Some banks obtain a pledge over goods relying on the doctrine of constructive possession, viz., by displaying name boards and locks bearing the bank's name affixed to godowns, premises, etc. where the pledged goods are stored and stationing godown watchmen. In some cases, the stationing of watchmen is also waived and keys to the premises are left with the borrower against an agreement that the keys are retained by him for the express purpose of obtaining access to the goods for processing and manufacturing. How would you rate the status of the security? Could it rank as a pledge or as a hypothecation?

16.19.2* Have you experienced any difficulty in establishing your claim to goods covered by key loan advances in the event of—

(i) the insolvency of the borrower; and

(ii) the borrower fraudulently further pledging the goods in favour of another person who may take the goods with or without notice of the earlier pledge?

*(*To be answered by banks and financial institutions*)

16.19.3* What precautions you take to ensure that you retain control over the stock-in-trade pledged in your favour and in regard to which the borrower is given the right of disposal?

*(*To be answered by banks and financial institutions*)

16.19.4 How would you distinguish between pledge of specific assets left in the borrower's business premises with a licence to the pledger to dispose of them in the course of his business and a floating charge in relation to such assets? If this distinction is not clear under the law as at present, would you like to set out the criteria on which a distinction could be based? If so, would you like to have them statutorily provided for?

[*vide* 1926 (50) Bom. 547; and 1926 (54) Cal. 513]

Group 20—Pledge—Registration

16.20.1 In relation to company-borrowers, as there is no provision for registration of the pledge over their assets, as distinct from a hypothecation of such assets, the bank ceases to have any protection if it allows the borrower to deal with the goods and the company fraudulently charges or disposes of the goods to persons having no knowledge of the pledge. This implies that when the goods are completely left

in the possession and control of the borrower as in the case of hypothecation, the interest of the lending institution is comparatively more secure than when borrower is allowed to deal with the goods for a limited purpose. In view of this, do you consider it necessary or desirable to permit registration also of such type of pledge transactions ?

[*vide* sections 125 and 126 of the Companies Act, 1956]

16.20.2 If you favour any provision for registration even in relation to pledges, would you consider it necessary or desirable to extend the scheme also to cover pledge over the assets of borrowers other than companies ?

Group 21—Trust receipts—Nature of

16.21.1 It has been stated that from the banker's point of view trust receipts may be considered valueless in view of the legal decisions in our country in relation to them. As granting of trust receipt facilities by banks in India, it is felt, would stimulate the commercial development of the comparatively smaller traders and dealers, what measures you would suggest for safeguarding the rights of the lender who parts with the pledged goods against trust receipts ?

[*vide* Indian Central Banking Enquiry Committee Report, 1931, para. 565 and Tannan on Banking, 12th Edition, page 382]

16.21.2 In Mercantile Bank of India Ltd. *v.* Chartered Bank of India, Australia and China and Strauss & Co. Ltd. (in liquidation) (No. 2) [1937 (4) All E.R. 651], it was held that instruments headed "trust receipts" did not create a trust and, therefore, not registrable under the Indian Trusts Act, 1882, but that such instruments created an equitable charge. In view of this, would you regard trust receipts as creating in favour of the lending institution any charge on the property and the relative advances as secured ?

[*vide* Paget, 7th Edition, page 550 and Mulla's Transfer of Property Act, 5th Edition, page 51]

16.21.3 While on the insolvency of a borrower, goods released against trust receipts are not affected by the reputed ownership clause in U.K., in India they are. Do you consider it necessary or desirable to effect a change in this regard ?

[*vide* in re. Hamilton Young, 1905 (2) K.B. 381 ; and A.I.R. 1932 Cal. 680]

16.21.4 Over the goods or documents of title relating thereto released to the borrower-pledgor for the purpose of disposal or for other special purposes against trust receipts, it has been held that no valid trust is created in favour of the pledgee-bank. Do you consider it necessary to impress such goods with the character of trust property ?

16.21.5 It has been held that when documents of title to goods are released to the borrower for the disposal of the goods, against a trust receipt, the borrower qualifies as a mercantile agent and that any unauthorised pledge of the documents of title by him will give such subsequent pledgee an effective pledge over the relative goods. Would you

suggest any measures to protect the lending institution releasing the documents against trust receipts from such contingencies ?

[*vide* 1938 (2) K.B. 147]

16.21.6 It has been felt that it may not be possible under the present law to prosecute a borrower to whom the goods are released against a trust receipt, if he subsequently deals with them unauthorisedly. Do you consider that the borrower should be made criminally liable for unauthorisedly dealing with the assets covered by the trust receipt ?

Group 22—Trust receipts—Legislation in U.S.A.

16.22.1 In U.S.A., the law relating to trust reecipts is now codified as part of the law relating to the creation of security over moveables. Do you consider it necessary or desirable to codify in India the law relating to trust receipts ?

Group 23—Trust receipt—Special legislation

16.23.1 In order to provide for the spread of trust receipt facility, do you consider it necessary or desirable to promote any special legislation for making trust receipts a more acceptable form of security for advances by lenders ? If so, whether or not you consider that the scope of such legislation should be confined only to trust receipts obtained by banks and other financial institutions ?

16.23.2 It has been expressed that the basic features of a trust receipt legislation should be—

(a) to define what is a trust receipt ;

(b) to set out the types of financial transactions in which, and the parties by whom, trust receipts may be employed within the protection of the Act ;

(c) to clarify the nature of the security interest which will be afforded by the trust receipt in the several types of transactions in which it may be employed ;

(d) to provide a machinery for registration of trust receipts or particulars thereof with a view to afford notice to third parties ; and

(e) to regulate the conditions under, and the circumstances in, which the lender in a trust receipt transaction will be protected against the claims of the borrower's trustee or liquidator in insolvency and those of third party purchasers or pledgees for value.

Do you consider that legislation in relation to trust receipts should provide for the above ? Or, would you like such legislation to cover also any other matters ? Please give your suggestions, if any, with reference to the matters you would like such legislation to cover.

Group 24—Comprehensive scheme of legislation regarding charges on movable assets

16.24.1 The rights of parties in relation to charges over movable assets are now mainly determined having regard to the form of the document obtained from the borrower, e.g., whether the document is considered as evidencing a mortgage, hypothecation, pledge, floating charge

or trust receipt over the relative movable assets. Do you consider it necessary or desirable to have the rights of parties in relation to a secured transaction determined mainly on the substance of the arrangement, such as the nature of the security, the purpose of the advance, whether it is possessory or not, whether there are means for the third parties to have a notice of the arrangement or not ?

16.24.2 Article 9 of the UCC provides for a "simple and unified structure within which the immense variety of present day secured financing transactions can go forward with less cost and greater certainty. The traditional distinctions among security devices based largely on form are not retained". Do you consider it necessary or desirable to have a similar unified scheme relating to charges over movable assets in India ?

16.24.3 Under Article 9 of the UCC, the rights of persons are determined essentially having regard to whether—

(a) the asset secured is in the possession of the lender or is left with the borrower or a bailee ;

(b) the charge is in respect of assets in existence or to be acquired later ;

(c) the charge secures an advance for enabling the borrower to acquire the asset charged or it relates to asset to which the borrower is already entitled ;

(d) the charge is perfected (e.g., by registration or possession) or it remains unperfected ;

(e) the assets are tangible goods, such as "consumer goods", "equipment", "farm products" or "stock-in-trade", or intangibles, such as documents of title to goods, negotiable instruments or chattel paper (e.g., hire-purchase agreement) or book debts or other contractual rights.

Do you consider it necessary or desirable to have a scheme of legislation determining the rights of parties essentially having regard to the aforesaid criteria ?

16.24.4 If you are in favour of such a legislative scheme, would you, or would you not, like that to cover the following types of transactions:

(a) mortgage over moveables ;

(b) hypothecation over moveables including actionable claims ;

(c) floating charge over moveables ;

(d) trust receipt for moveables ;

(e) pledge of moveables including documents of title to goods ;

(f) hire-purchase financing of goods ?

16.24.5 The UCC provides generally for registration of charges (in relation to non-possessory claims), which not only makes information in the registers more easily accessible but also reduces considerably the cost of procuring credit information. Do you consider it necessary or desirable to evolve a similar scheme in India ?

Group 25—Special provisions for banks

16.25.1 Under the co-operative societies enactments, the co-operative banks get a statutory first charge—

(a) upon the crops or agricultural produce of the member for the raising of which the loan was taken from the co-operative bank by the member ;

(b) upon the cattle, fodder for cattle, agricultural produce or industrial implements, machinery or raw materials for manufacture supplied or purchased in whole or in part out of the loan given by the co-operative bank or upon any articles manufactured from the raw materials so supplied or purchased.

Do you consider it necessary or desirable to provide for such first charge in relation to such advances given by all or any classes of banks ?

16.25.2 The Gujarat Co-operative Societies Act, 1961, provides that the society shall have a first charge (subject to Government's dues in respect of land revenue) for the dues of a borrower-member, *inter alia,* upon "any movable property which may have been hypothecated, pledged or otherwise mortgaged by him with the society and remaining in his custody". Do you consider it a desirable provision in the light of the equities to be observed between different classes of lenders? If so, would you like to give such first charge in relation to such security in favour of all or any classes of banks ?

16.25.3 Under the co-operative societies enactments, a property subject to the aforesaid charge is not to be sold or otherwise transferred or converted in any manner without the permission of the society. Are you in favour of such a provision in relation to all or any classes of banks ?

16.25.4 Under the co-operative societies enactments in certain States, e.g., Tamil Nadu and Pondicherry, a co-operative bank has the power of calling upon the borrower-member or his representative to deposit with or entrust to the custody of the co-operative bank property which is subject to such charge until the debt or outstandings are fully paid, the expenses in connection therewith to be borne by the borrower-member or his representative. Do you consider that it is necessary or desirable to have a similar provision in favour of all or any classes of banks ?

16.25.5 In relation to such priorities in respect of advances by co-operative banks, do you consider it necessary or desirable to provide for a scheme of registration of such charges to enable others dealing with the charged assets to have notice thereof ? If you consider so, please give your suggestions as to the scheme of registration that could be contemplated in this behalf.

PART 17—CHARGE ON FIXTURES

Group 1—General

17.1.1 Please state the difficulties, if any, you are aware of, in relation to advances against machinery or other movable assets which are, or which are to be, attached or annexed to immovable property.

Group 2—Distinction between movable and immovable assets

17.2.1 The mode of creation and the manner of enforcement of a charge on a fixture now depends mainly on the question whether the fixture is a movable or an immovable asset. Do you consider that while making advances against fixtures, such as, machinery and other like assets, the question wheter they are movable or immovable assets is easy of determination ?

17.2.2 It has been stated that to decide whether a fixture is a movable or an immovable asset, "certain tests have been formulated in particular contexts, which, if literally applied, may not yield always a proper and correct result" and that "while general tests pointed out by judicial decisions, in the light of specific facts, may be borne in mind, eventually the decision on the question should depend upon how the Court, looking at the facts as a whole, feels on the matter". In view of this, do you consider that the rights and obligations of parties while making advances against fixtures should be made to depend on the question whether ultimately the asset would be regarded as "movable" or "immovable" by the Court ?

[*vide* 1968 (2) M.L.J. 493-A.I.R. 1969 Mad. 346 ; and 1968 (2) M.L.J. 596]

17.2.3 Under the UCC* the rights and obligations of parties in relation to advances against fixtures (other than goods such as lumber, bricks, tiles, cement, glass, metal work and the like incorporated into an immovable structure) are determined without reference to the question whther the fixture is to be regarded as movable or an immovable asset. Do you consider that while dealing with finance against fixtures it is necessary or desirable to so determine the rights and obligations of parties in India ?

Group 3—Charge on machinery, etc. which subsequently become fixtures

17.3.1 Do you consider that the mode of creation of a charge over machinery or other like goods should depend on whether or not such asset is subsequently going to be a fixture and an immovable asset ?

17.3.2 Do you consider that at present the hypothecation or other charge over machinery or other like goods (on the basis that they are movable assets) is affected when subsequently such asset becomes a fixture and an immovable asset ? Or, do you consider it necessary or desirable to clarify the position in this regard ?

17.3.3 Under the UCC, a secured claim over machinery or other like goods is not affected by reason of the fact that such asset has become a fixture and an immovable asset. Do you consider it necessary or desirable to provide so in India ?

Group 4—Priority as to fixtures

17.4.1 How are the rights of those claiming a charge on the fixture and those claiming a charge on the immovable structure of which the asset

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*Some provisions of the American scheme relating to fixtures are referred to in the questions that follow.

is a fixture, now reconciled? Do you consider that the position in this regard is not sufficiently clear? If so, would you like to have it statutorily clarified?

17.4.2 In U.S.A., a charge, on machinery or other like goods, which attaches *before* they become fixtures, generally takes priority in relation to such fixture over the claims of all persons who have an interests in the real estate. Are you in favour of such a general provision?

[*vide* section 9-313 of the UCC]

17.4.3 In U.S.A., a charge over machinery or other like goods created *after* they became fixtures is generally valid only against persons acquiring interest in the real estate subsequent to the creation of the charge over the fixture, but not against any person already having an interest in the real estate unless he acquiesces to the charge on the fixture. Do you feel that a provision on these lines is necessary or desirable in India?

[*vide* section 9-313 of the UCC]

17.4.4 In U.S.A., a charge on such fixture does not rank in priority over the claims of—

(a) subsequent purchaser for value of any interest in the real estate; or

(b) a creditor with a lien on the real estate subsequently obtained by judicial proceedings; or

(c) a creditor with a prior encumbrance on record on the real estate to the extent that he makes advances

if such subsequent purchase/lien/advance is made/obtained/contracted without knowledge and before perfection (e.g., registration) of the charge on the fixture. Do you consider that if the charge on the fixture is to be maintained against persons claiming interest in the real estate, the aforesaid classes of persons should be exempted?

[*vide* section 9-313 of the U.CC]

Group 5—Fixtures—Rights of a charge holder

17.5.1 Do you consider that when a lending institution obtains a charge on machinery or other like goods, it can have the right of removing the fixture from the real estate? Would you like a specific provision on these lines?

17.5.2 In U.S.A., a person advancing against a fixture may, on default by the borrower, remove the fixture from the real estate, but he must reimburse any encumbrancer or the owner of the real estate (other than the debtor) for the cost of repair of any physical injury, but not for any diminution in value of the real estate, caused by the absence of the goods removed or by any necessity for replacing them. Do you consider that it is necessary or desirable to have such a provision in India?

[*vide* section 9-313(5) of the UCC]

17.5.3 Do you consider it necessary or desirable to provide for the lending institution advancing against fixture the same rights as are allowed to it if it were a mere charge on a movable asset?

Group 6—Fixtures—Registration of charge thereon

17.6.1 Do you consider it necessary or desirable to provide for a scheme of registration of charges over the fixtures, whether they are part of the real estate or not ?

17.6.2 Under the UCC, a charge on a fixture is ordinarily perfected only if it is registered. Do you consider it necessary or desirable to provide so in India ?

17.6.3 In U.S.A., a charge on goods which are, or which are to become, fixtures is ordinarily required to be registered in the office where a mortgage on the real estate concerned would be registered. Do you consider that charges on goods which are, or which are to become, fixtures could be required to be registered with the concerned Sub-Registrar in India ? If so, would you like them also to be registered with the Registrars of Companies (as is now done)?

[*vide* section 9-401 of the UCC]

17.6.4 If charges on fixtures are required to be registered, would you like to ensure that the cost of such registration by way of stamp and registration charges is eliminated or reduced to the minimum in order to facilitate advances against fixtures by banks ?

Group 7—Charge on fixtures vis-a-vis special provisions in favour of co-operative banks

17.7.1 Under the co-operative societies enactments, a co-operative bank/land development bank is given a priority to recover its dues against the immovable assets of the borrower. Do you consider that to facilitate advances against fixtures by commercial banks and other financial institutions, it is necessary or desirable to provide that such priority in favour of the co-operative bank/land development bank does not come in the way of the charge in favour of the institution financing against the fixtures ?

Group 8—Uniform legislation to cover also fixtures

17.8.1 Under the American scheme, the codification of the law as to transactions secured against movable assets covers also those secured against fixtures, and the general provisions also apply to fixtures as security, so far as they may be. On similar lines, do you consider it necessary or desirable for a scheme of legislation covering charges over movable assets to cover also fixtures, whether they are regarded as movable or immovable assets ?

ANNEXURE 3

INSTITUTIONS AND INDIVIDUALS TO WHOM QUESTIONNAIRE IN ENGLISH/HINDI WAS SENT

1. Concerned Departments of the Government of India
2. Departments of State Governments and Union Territories
3. Law Commission of India
4. Registrars of Companies
5. Registrars of Co-operative Societies
6. All Scheduled and non-Scheduled Commercial Banks
7. All State Co-operative Banks
8. Selected Urban and District Central Co-operative Banks
9. Industrial Development Bank of India, Industrial Finance Corporation, Industrial Reconstruction Corporation of India Ltd., Industrial Credit and Investment Corporation of India Ltd., State Financial Corportations, Life Insurance Corporation of India and such other financial corporations
10. Indian Banks' Association
11. Foreign Exchange Dealers' Association
12. All India State Co-operative Banks' Federation
13. All India Institute of Chartered Accountants and their regional associations
14. Bar Council of India
15. Bar Association of India
16. Supreme Court Bar Association
17. State Bar Councils
18. Bar Associations of High Courts
19. All District Bar Associations
20. Federation of Indian Chambers of Commerce and Industry
21. Indian Merchants' Chamber
22. Chambers of Commerce in various States and Union Territories
23. Stock Exchanges
24. Merchants' Associations in various States and Union Territories
25. Manufacturers' Associations and other producers' associations in various States and the Union Territory of Delhi
26. Educational and Training Institutions.
27. University Law Departments
28. Foreign Central Banks and Foreign Experts.
29. Senior and Middle Level Executives of Reserve Bank of India and its associate Institutions, and of other commercial banks
30. Specified Individuals including those who have requested for copies of the Terms of Reference/Questionnaire.

ANNEXURE 4

INSTITUTIONS AND INDIVIDUALS WHO ANSWERED THE QUESTIONNAIRE (INCLUDING THE HINDI VERSION) OR SUBMITTED MEMORANDA

A. RE. LOANS AND ADVANCES BY BANKS—GENERAL

(Part 13 of the Questionnaire)

1. Bank of India
2. Bank of Baroda
3. Punjab National Bank
4. Canara Bank
5. United Commercial Bank
6. Syndicate Bank
7. Indian Bank
8. Allahabad Bank
9. State Bank of Travancore
10. State Bank of Saurashtra
11. Corporation Bank Ltd.
12. State Bank of Indore
13. Bank of Madura Ltd.
14. Karnataka Bank Ltd.
15. Jammu and Kashmir Bank Ltd.
16. South Indian Bank Ltd.
17. Federal Bank Ltd.
18. Karur Vysya Bank Ltd.
19. Vysya Bank Ltd.
20. Benares State Bank Ltd.
21. Tanjore Permanent Bank Ltd.
22. Belgaum Bank Ltd.
23. Hindustan Mercantile Bank Ltd.
24. Grindlays Bank Ltd.
25. Chartered Bank
26. Andhra Pradesh State Co-operative Bank Ltd.
27. Gujarat State Co-operative Bank Ltd.
28. Himachal Pradesh State Co-operative Bank Ltd.
29. Rajasthan State Co-operative Bank Ltd.
30. Agricultural Finance Corporation
31. Industrial Finance Corporation of India

32. Assam Financial Corporation
33. Gujarat State Financial Corporation
34. Uttar Pradesh Financial Corporation
35. Gandhi Co-operative Urban Bank Ltd., Vijayawada
36. All-India State Co-operative Banks' Federation
37. Indian Council of Economic Affairs, Calcutta
38. Federation of Indian Manufacturers, New Delhi
39. Andhra Pradesh High Court Advocates' Association, Hyderabad
40. Frontier Chamber of Commerce, Shillong
41. Bellary District Chamber of Commerce, Bellary
42. Bombay Incorporated Law Society, Bombay
43. Madras Stock Exchange, Madras
44. Registrar of Co-operative Societies, Goa, Daman & Diu, Panaji
45. Registrar of Co-operative Societies, Madhya Pradesh, Bhopal
46. Registrar of Co-operative Societies, New Delhi
47. Registrar of Co-operative Societies, Orissa, Bhubaneshwar
48. Government of West Bengal, Ministry of Finance, Calcutta
49. Department of Banking Operations and Development, Reserve Bank of India, Jammu
50. Principal, Co-operative Bankers' Training College, Pune
51. Manager, Syndicate Bank, Goa
52. Advocate-General, Tripura
53. Shri Aleem M.A., State Bank of Mysore, Bangalore
54. Shri Bhandari M. C., Calcutta
55. Shri Bhat K. G., Syndicate Bank, Visakhapatnam
56. Shri Bhat M. V., Vijaya Bank Ltd., Bangalore
57. Shri Bhattacharjee B. B., State Bank of Bikaner and Jaipur, Head Office, Jaipur
58. Shri Challisery D. T., Deputy Chief Officer, Agricultural Credit Department, Reserve Bank of India, Bangalore
59. Shri Gandhi C. T., Calcutta
60. Shri Hate M. V., Joint Chief Officer, Agricultural Credit Department, Reserve Bank of India, Bombay
61. Shri Hussain K. M., State Bank of Mysore, Bangalore
62. Shri Inasu M. L., Chairman, Purbanchal Bank Ltd., Gauhati
63. Shri Kaka P. N., Pune
64. Shri Karuppanchetty M. R., Joint Chief Officer, Department of Banking Operations and Development, Reserve Bank of India, Calcutta
65. Shri Keshava Ammannayya, Panja (Karnataka)
66. Shri Madusudan Rao P., Syndicate Bank, Manipal
67. Shri Mathur P. S., State Bank of Bikaner and Jaipur, Bharatpur
68. Shri Mehta K. C., Bank of Baroda, Ahmedabad

69. Shri Nanjappa B. R., State Bank of Mysore, Mandya
70. Shri Nanjappa K. M., Coorg
71. Shri Narayana Murthy P., State Bank of Mysore, Bangalore
72. Shri Noronha E. G., Deputy Chief Officer, Department of Banking Operations and Development, Reserve Bank of India, Ahmedabad
73. Dr. Ponnuswamy K., Faculty of Law, University of Delhi, Delhi
74. Shri Ramakrishnan V., Instructor, Staff College, Indian Overseas Bank, Madras
75. Shri Rao B. R., Syndicate Bank, Manipal
76. Shri Sen Gupta C. R., Manager, Industrial Development Bank of India, Calcutta
77. Shri Shah R. A., Cambay
78. Shri Shetty B. B., Syndicate Bank, Manipal
79. Shri Shimoga S. V., Dena Bank, Rajim
80. Shri Singde B. S., Syndicate Bank, Pune
81. Shri Singh J. B., Deputy Secretary to Government of Orissa, Bhubaneshwar
82. Shri Sreeramachandramurthy K., State Bank of Mysore, Bangalore
83. Shri Subramanian A., Staff Training Centre, State Bank of Hyderabad, Aurangabad
84. Shri Venkata Ramanan K., State Bank of Mysore, Bangalore
85. Shri Venkoba Rao K., Madras
86. Shri Pendse, D. D., Tata Engineering & Locomotive Co. Ltd Bombay

FOREIGN EXPERTS

87. Mr. Carl W. Funk, Philadelphia (U.S.A.)
88. Mr. Maurice Megrah, London.

B. RE. CHARGE ON MOVABLE ASSETS
(Part 16 of the Questionnaire)

1. Bank of India
2. Bank of Baroda
3. Punjab National Bank
4. Canara Bank
5. Syndicate Bank
6. Indian Bank
7. Allahabad Bank
8. Corporation Bank Ltd.
9. Bank of Madura Ltd.
10. Karnataka Bank Ltd.
11. Jammu and Kashmir Bank Ltd.
12. South Indian Bank Ltd.
13. Federal Bank Ltd.

14. Karur Vysya Bank Ltd.
15. Vysya Bank Ltd.
16. Benares State Bank Ltd.
17. Tanjore Permanent Bank Ltd.
18. Belgaum Bank Ltd.
19. Hindustan Mercantile Bank Ltd.
20. Grindlays Bank Ltd.
21. Chartered Bank
22. Andhra Pradesh State Co-operative Bank Ltd.
23. Himachal Pradesh State Co-operative Bank Ltd.
24. Rajasthan State Co-operative Bank Ltd.
25. Industrial Finance Corporation of India
26. Assam Financial Corporation
27. Gujarat State Financial Corporation
28. Uttar Pradesh Financial Corporation
29. Gandhi Co-operative Urban Bank Ltd., Vijayawada
30. All-India State Co-operative Banks' Federation
31. Indian Council of Economic Affairs, Calcutta
32. Federation of Indian Manufacturers, New Delhi
33. Andhra Pradesh High Court Advocates' Association, Hyderabad
34. Frontier Chamber of Commerce, Shillong
35. Bombay Incorporated Law Society, Bombay
36. Madras Stock Exchange, Madras
37. King and Patridge, Madras
38. Registrar of Co-operative Societies, Goa, Daman and Diu, Panaji
39. Registrar of Co-operative Societies, Madhya Pradesh, Bhopal
40. Registrar of Co-operative Societies, New Delhi
41. Registrar of Co-operative Societies, Orissa, Bhubaneshwar
42. Government of India, Ministry of Industrial Development and Internal Trade, New Delhi
43. Government of Andhra Pradesh, Home Department, Hyderabad
44. Government of Maharashtra, Agriculture and Co-operation Department, Bombay
45. Government of Uttar Pradesh, Lucknow
46. Department of Banking Operations and Development, Reserve Bank of India, Jammu
47. Deputy Chief Officer, Department of Banking Operations and Development, Reserve Bank of India, Ahmedabad
48. Principal, Co-operative Bankers' Training College, Pune
49. Manager, Syndicate Bank, Goa
50. Manager, State Bank of Mysore, Mandya
51. Advocate-General, Tripura

52. Shri Aleem M. A., State Bank of Mysore, Bangalore
53. Shri Bhat K. G., Syndicate Bank, Visakhapatnam
54. Shri Bhat M. V., Vijaya Bank Ltd., Bangalore
55. Shri Bhattacharjee B. B., State Bank of Bikaner and Jaipur, Head Office, Jaipur
56. Shri Gandhi C. T., Calcutta
57. Shri Hussain K. M., State Bank of Mysore, Bangalore
58. Shri Inasu M. L., Chairman, Purbanchal Bank Ltd., Gauhati
59. Shri Kaka P. N., Pune
60. Shri Karuppanchetty M. R., Joint Chief Officer, Department of Banking Operations and Development, Reserve Bank of India, Calcutta
61. Shri Keshava Ammannayya, Panja (Karnataka)
62. Shri Madusudan Rao P., Syndicate Bank, Manipal
63. Shri Mathur P. S., State Bank of Bikaner and Jaipur, Bharatpur
64. Shri Mehta K. C., Bank of Baroda, Ahmedabad
65. Shri Nanjappa K. M., Coorg
66. Shri Pinto A. J., Syndicate Bank, Manipal
67 Dr. Ponnuswamy K., Faculty of Law, University of Delhi, Delhi
68. Shri Ramakrishnan V., Instructor, Staff College, Indian Overseas Bank, Madras
69. Shri Ramaseshan V., Lecturer, University of Madras, Madras
70. Shri Rao B. R., Syndicate Bank, Manipal
71. Shri Sastri D. S., Madras
72. Shri Sen Gupta C. R., Manager, Industrial Development Bank of India, Calcutta
73. Shri Shah R. A., Cambay
74. Shri Shetty B. B., Syndicate Bank, Manipal
75. Shri Singh J. B., Deputy Secretary to Government of Orissa, Bhubaneshwar
76. Shri Sreeramachandramurthy K., State Bank of Mysore, Bangalore
77. Shri Subramanian A., Staff Training Centre, State Bank of Hyderabad, Aurangabad
78. Shri Venkata Ramanan K., State Bank of Mysore, Bangalore
79. Shri Venkoba Rao K., Madras

FOREIGN EXPERTS

80. Mr. Carl W. Funk, Philadelphia (U.S.A.)
81. Mr. Maurice Megrah, London

C. RE. CHARGE ON FIXTURES

(Part 17 of the Questionnaire)

1. Bank of India
2. Bank of Baroda

52. Shri Aleem M. A., State Bank of Mysore, Bangalore
53. Shri Bhat K. G., Syndicate Bank, Visakhapatnam
54. Shri Bhat M. V., Vijaya Bank Ltd., Bangalore
55. Shri Bhattacharjee B. B., State Bank of Bikaner and Jaipur, Head Office, Jaipur
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57. Shri Hussain K. M., State Bank of Mysore, Bangalore
58. Shri Inasu M. L., Chairman, Purbanchal Bank Ltd., Gauhati
59. Shri Kaka P. N., Pune
60. Shri Karuppanchetty M. R., Joint Chief Officer, Department of Banking Operations and Development, Reserve Bank of India, Calcutta
61. Shri Keshava Ammannayya, Panja (Karnataka)
62. Shri Madusudan Rao P., Syndicate Bank, Manipal
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69. Shri Ramaseshan V., Lecturer, University of Madras, Madras
70. Shri Rao B. R., Syndicate Bank, Manipal
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78. Shri Venkata Ramanan K., State Bank of Mysore, Bangalore
79. Shri Venkoba Rao K., Madras

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C. RE. CHARGE ON FIXTURES

(Part 17 of the Questionnaire)

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13. Jammu and Kashmir Bank Ltd.
14. South Indian Bank Ltd.
15. Federal Bank Ltd.
16. Karur Vysya Bank Ltd.
17. Vysya Bank Ltd.
18. Benares State Bank Ltd.
19. Tanjore Permanent Bank Ltd.
20. Belgaum Bank Ltd.
21. Hindustan Mercantile Bank Ltd.
22. Grindlays Bank Ltd.
23. Chartered Bank
24. Andhra Pradesh State Co-operative Bank Ltd.
25. Himachal Pradesh State Co-operative Bank Ltd.
26. Rajasthan State Co-operative Bank Ltd.
27. Agricultural Finance Corporation
28. Industrial Finance Corporation of India
29. Assam Financial Corporation
30. Gujarat State Financial Corporation
31. Uttar Pradesh Financial Corporation
32. Gandhi Co-operative Urban Bank Ltd., Vijayawada
33. All-India State Co-operative Banks' Federation
34. Indian Council of Economic Affairs, Calcutta
35. Federation of Indian Manufacturers, New Delhi
36. Andhra Pradesh High Court Advocates' Association, Hyderabad
37. Frontier Chamber of Commerce, Shillong
38. Bombay Incorporated Law Society, Bombay
39. Madras Stock Exchange, Madras
40. Amalgamations Ltd., Madras
41. Registrar of Co-operative Societies, Goa, Daman and Diu, Panaji
42. Registrar of Co-operative Societies, Madhya Pradesh, Bhopal
43. Registrar of Co-operative Societies, New Delhi

44. Government of Gujarat, Agriculture, Forest and Co-operation Department, Ahmedabad
45. Government of Uttar Pradesh, Finance Department, Lucknow
46. Manager, Syndicate Bank, Goa
47. Shri Aleem M. A., State Bank of Mysore, Bangalore
48. Shri Bhat K. G., Syndicate Bank, Visakhapatnam
49. Shri Hussain K. M., State Bank of Mysore, Bangalore
50. Shri Inasu M. L., Chairman, Purbanchal Bank Ltd., Gauhati
51. Shri Kaka P. N., Pune
52. Shri Karuppanchetty M. R., Joint Chief Officer, Department of Banking Operations and Development, Reserve Bank of India, Calcutta
53. Shri Madusudan Rao P., Syndicate Bank, Manipal
54. Shri Mathur P. S., State Bank of Bikaner and Jaipur, Bharatpur
55. Shri Mehta K. C., Bank of Baroda, Ahmedabad
56. Shri Nanjappa B. R., State Bank of Mysore, Mandya
57. Shri Nanjappa K. M., Coorg
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59. Shri Ramakrishnan V., Instructor, Staff College, Indian Overseas Bank, Madras
60. Shri Rao B. R., Syndicate Bank, Manipal
61. Shri Shah R. A., Cambay
62. Shri Shetty B. B., Syndicate Bank, Manipal
63. Shri Sreeramachandramurthy K., State Bank of Mysore, Bangalore
64. Shri Subramanian A., Staff Training Centre, State Bank of Hyderabad, Aurangabad
65. Shri Venkata Ramanan K., State Bank of Mysore, Bangalore
66. Shri Venkoba Rao K., Madras

FOREIGN EXPERTS

67. Mr. Carl W. Funk, Philadelphia (U.S.A.)
68. Mr. Maurice Megrah, London.

REPLIES OF MR. CARL W. FUNK* TO THE QUESTIONNAIRE RELATING TO THE LAW IN REGARD TO LOANS AND ADVANCES BY BANKS AND OTHER FINANCIAL INSTITUTIONS — CHARGE ON MOVABLE ASSETS

PART 13—LOANS AND ADVANCES BY BANKS—GENERAL

Group 1—vis-a-vis the law in other countries

13.1.1 I consider it desirable that the law in India relating to loans and advances by banking and other allied institutions should, as far as possible, be in line with the law of other developed countries. However, I regard this as of much less importance than having the law uniform within India itself, and I question how feasible it will be to achieve world uniformity on these subjects. Every attempt should be made to do this but it must also be realized that legal concepts in various parts of the world are so different that the achievement of uniformity is probably not possible. Furthermore, we have found in the U.S.A. that it was much more difficult to achieve uniformity among the several states where loans and advances are secured by real property than it is when they are secured by personal property or are unsecured. The only areas in which the Uniform Commercial Code touches the law of real property are those connected with fixtures, crops and timber, and oil, gas and other minerals; and in these areas uniformity has been the most difficult to obtain even in a Uniform Commercial Code.

13.1.2 Subject to the foregoing answer, I do consider it desirable to have in India a statutory scheme similar to Article 9 of the UCC.

13.1.3 I refrain from answering this question because of lack of knowledge of the Agricultural Credits Act, 1928 of U.K.

Group 2—Special provisions relating to financial institutions

13.2.1 } I refrain from answering these questions because of unfamiliarity with
13.2.2 } conditions and legislation in India.

PART 16—CHARGE ON MOVABLE ASSETS

Group 1 — General

16.1.1 I refrain from answering this question because of lack of knowledge of the difficulties which may have been experienced in India in obtaining movable assets as security for loans and advances.

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*Former Member of the Pennsylvania Banking Law Commission, Counsel to the Permanent Editorial Board of the American Law Institute, and the Conference of Commissioners on Uniform State Laws; and an Author on Uniform Commercial Code.

16.1.2 I believe that it is necessary to codify the law of any country concerning the taking of movable assets as security for loans and advances. This has certainly been the experience in the U.S.A. In the beginning when the thirteen colonies of Great Britain were operating under the English common law and a few Acts of Parliament, and after the American Revolution when they continued to do this, movable assets were probably seldom used as security for loans, and then were used only by way of pledge, with delivery of possession to the creditor. Thereafter statutes were gradually adopted in the various states permitting security to be taken in tangible movable assets by means of chattel mortgages. Later the concept of a conditional sale was developed and legislation, sometimes requiring recording and sometimes not, permitted the retention of security interests in goods sold as collateral for the payment of their purchase price. Still later, legislation was adopted in a number of states validating trust receipts and factor's liens. The legal history of this development in the U.S.A. will be found at length in "Security Interests in Personal Property" by Grant Gilmore, Professor of Law, University of Chicago Law School, Chicago, Illinois, 2 Volumes, published in 1965 by Little, Brown & Company of Boston and Toronto.

16.1.3 I would favor legislation in India comparable to UCC Article 9, which codified all of the law referred to in the answer to the preceding question.

Group 2 — Hypothecation — Nature of

16.2.1 In answering this question, I am assuming that "by hypothecation" is used in the questionnaire to refer to the creation of a security interest without delivery of possession to the secured party, as distinguished from a pledge, a term used in the questionnaire referring to the creation of a security interest in movables which are physically delivered to the secured party. I have difficulty answering the question because I have never been satisfied in my own mind as to the meaning of the terms "equitable charge" or "equitable lien", although I have found them used in many decisions. Gilmore, at page 200, has said: "Like the Holy Roman Empire, which was said to be neither holy nor Roman nor an empire, the equitable lien is neither equitable nor a lien." In my judgment, so far as the law of the U.S.A. is concerned, it is a term of such uncertain meaning that its use is to be avoided.

16.2.2 I refrain from answering this question because of lack of knowledge of the law in India concerning legal and equitable estates.

Group 3 — Hypothecation and future advances

16.3.1 I refrain from answering this question because of lack of knowledge of the law of India concerning the necessity of specifying a limit in relation to future advances where movable assets are offered as security.

16.3.2 I favor provisions along the lines of UCC section 9-204(5) permitting the creation of a security interest as security not only for a contemporaneous loan or advance but also for future loans and advances.

Group 4 — Hypothecation — After acquired property

16.4.1 I refrain from answering the first question because of lack of knowledge of difficulties in India in relation to hypothecation documents covering after acquired property. I believe that if there are such difficulties, the position of the secured party should be clarified.

16.4.2 I would favor a provision in India similar to UCC Section 4-204(3) permitting after acquired property of the borrower to become automatically subject to a security interest or charge created at some earlier time.

16.4.3 I do not consider that a provision along the lines of UCC Section 9-204(4)(a) is desirable in India in relation to the hypothecation of crops. This provision has not proved helpful in the U.S.A., and the Review Committee on Article 9 has proposed that it be eliminated from the Code. For the reasons for this proposal see Final Report of the Review Committee, at page 66, and 1972 Official Text and Comments of Article 9, a copy of which is being forwarded under separate cover. The 1972 Official Text differs from the Final Report only in minor respects.

Group 5 — Hypothecation — Enforceability against third parties

16.5.1 I do not know what steps are taken in India to notify third parties of the hypothecatees' interest in movable assets and therefore cannot say whether such steps are effective. In the U.S.A. such notice is given by the filing of a financial statement under the UCC in one or more specified filing offices.

16.5.2 I refrain from answering this question because of lack of knowledge concerning the Registrar of Companies.

16.5.3 I consider it desirable to have the same provisions for registration or filing over hypothecation applicable to borrowers whether they are companies or other legal persons.

16.5.4 It would appear to me to be necessary to provide for registration of hypothecation with some official other than the Registrar of Companies in order to give notice of hypothecation charges over assets of borrowers other than companies.

16.5.5 I consider it desirable to provide for a scheme of registration of hypothecation charges over the assets of all types of borrowers, including companies, with a single official. In the U.S.A., this is usually the Secretary of State of each state.

16.5.6 I feel it would be desirable to provide for registration of mortgages over movables in India but this should be done through the enactment of a statute similar to UCC Article 9, rather than by a separate statute dealing only with chattel mortgages or conditional sales.

16.5.7 I consider it desirable to provide in India that an assignment of movables by way of security must be by a written instrument, except in the case of a pledge of the movables by their delivery to the secured party.

16.5.8 I would not wish to exempt any specified minimum amount from a scheme of registration in relation to hypothecation or mortgage of movable assets. I prefer the system found in UCC Article 9, where most, but not all, security interests in goods of consumers are relieved from the necessity of registration or filing; but I would require filing or its equivalent in all transactions not involving consumers.

Group 6 — Hypothecation — Enforceability against Official Assignee/ Receiver

16.6.1 I refrain from answering this question because of lack of knowledge of the law and proceedings in India with respect to insolvency.

16.6.2 It is difficult for me to answer this question because of lack of knowledge of trust receipts in the U.K. and of its bankruptcy law. I favor the use of trust receipts in appropriate transactions, provided some method, such as registration or filing, is employed to give notice to third persons, except in transactions which are consummated within a very short period of time, such as 21 days.

16.6.3 I believe that if a bank, either itself or through a third person, such as a field warehouse company, has taken actual possession of movables, by means of persons who are in no way connected with the borrower and who have absolute power to deny possession of the goods to the borrower, the reputed ownership doctrine should be inapplicable, even though the goods remain on the borrower's premises. I do not know whether or not this now is true in India but if not, it should be made clear by legislation.

16.6.4 To avoid the reputed ownership doctrine, a banker or his agent (including a field warehousing company and its employees) should have absolute control over the goods and the borrower should have no access to them or no ability to obtain possession of them until they are deliberately released to the borrower by the banker or lending institution or its agents. The portion of the premises of the borrower where the goods are kept should be leased to the lender or his agent, should be physically separated from the remaining premises, and should be kept locked so that only the agent can have access to them.

16.6.5 I am not familiar with the decisions of English courts showing a tendency to limit the application of the doctrine of reputed ownership. I do not agree that it is a serious invasion on the rights of the owner of the goods, because, as I understand the situation, any limitation on the rights of the owner can arise only because he desires to use the goods as security for money which he wishes to borrow and therefore any limitation on his rights of ownership are the results of his own actions.

16.6.6 I would exclude from the scope of the reputed ownership clause the hypothecated assets of borrowers only to the extent that public notice of their hypothecation had been given in some manner such as by registration or in the U.S.A. by a UCC filing.

16.6.7 I refrain from answering this question because of lack of knowledge of the Companies Act, 1956.

16.6.8 As stated above, I consider that hypothecated assets of companies should go out of the reach of the reputed ownership clause if the relative hyphothecation has been duly registered or filed.

16.6.9 I consider that if hypothecation of assets of all types of borrowers could be registered with a public authority the interest of the lender would be adequately protected on the insolvency of the borrower.

Group 7 — Hypothecation — Motor vehicles

16.7.1 } I refrain from answering these questions because of lack of knowledge
16.7.2 } of charges or liens upon or security interests in motor vehicles in India.

16.7.3 I consider desirable a provision that a charge or lien upon, or a security interest in a motor vehicle shall not be valid against lenders and third parties unless and until it is noted on a certificate of title of the vehicle, as is required by most states of the U.S.A.

16.7.4 I consider it desirable to have provisions making charges or liens on motor vehicles indicated on a certificate of title, a record of which is available to the public for inspection.

16.7.5 I consider it desirable to provide that the person having the first charge on a motor vehicle has the right to possession of the certificate of title. If the borrower has the right to possession, he may be enabled to engage in sale or other loan transactions to the detriment of the person having the first charge.

Group 8 — Hypothecation — Stamp duty

16.8.1 } I refrain from answering these questions because of lack of knowledge
16.8.2 } of stamp duties in India.

Group 9 — Hypothecation — Priorities

16.9.1 I would like to determine the order of priority between persons claiming the same hypothecated asset as security primarily on the basis of the date when the hypothecation charge was first registered, unless prior to registration another person has taken possession of the asset, in which case that person should have priority.

16.9.2 I would generally favor a provision along the lines set forth in the question to settle the rules with regard to priority in India between two hypothecation charges. However, I must point out that the problem is a very complex one. If the hypothecation is to secure the purchase price of goods or money furnished for the payment of their purchase price, then, under certain conditions, that lender or creditor should have a priority over other holders of hypothecation charges. Furthermore, there may be a contest between the holder of a hypothecation charge and someone who either before or after the creation of that charge, received a pledge of the movables accompanied by possession. The priority rules of the UCC as presently in effect, do not deal with all these complexities but it is believed the rules set forth in the Final Report of the Review Committee cover most or all of them in a satisfactory manner.

16.9.3 I consider it desirable to provide in India for preferential claims in relation to the types of financing listed in the question.

16.9.4 The interest of the first hypothecatee should be protected in all of the situations listed in the question. I cannot state whether his interest is adequately protected in India today. It is wherever the UCC is in effect in the U.S.A.

Group 10 — Hypothecation — Proceeds

16.10.1 I refrain from answering this question because of lack of knowledge of the present law in India.

16.10.2 I consider it desirable to provide in India that the lender's claim over the secured asset also covers identifiable proceeds.

16.10.3 I consider it desirable to provide in India that the lender's claim ordinarily continues notwithstanding the sale, exchange or other disposition of the secured asset.

16.10.4 I consider it desirable to provide that a hypothecatee's interest is preserved when the identity of the asset is lost in the course of manufacture, etc. I favor the UCC position.

Group 11 — Hypothecation — Rights of a hypothecatee

16.11.1 to 16.11.4 I refrain from answering these questions because of lack of knowledge of the present law of India.

16.11.5 I consider it desirable to provide in India for the remedies in favor of the lender listed in the question. I must point out that the United States District Court for the Southern District of California has held that section 9-503 of the UCC, which permits an hypothecatee to take possession of the goods upon default if he can do so without breach of the peace, violates the due process clause of the Fourteenth Amendment of the United States Constitution, because possession may be taken without a prior hearing where the debtor has an opportunity to be heard and therefore denies him due process of law. *Adams* v. *Egley*, 338 Federal Supplement 614 (1972). This decision has been appealed to the United States Court of Appeals for the Ninth Circuit, and the case should ultimately reach the Supreme Court of the United States. A number of other courts have upheld the constitutionality of section 9-503.

16.11.6 I consider it desirable to give a right to accessions to the hypothecatee.

Group 12 — Floating Charge — Nature of

16.12.1 } I refrain from answering these questions because of lack of knowledge
16.12.2 } of the present law of India concerning equitable charges.

Group 13 — Floating charge — How determined.

16.13.1 to 16.13.3 I refrain from answering these questions because I am not a bank or financial institution, and because of my lack of knowledge of the present law of India, concerning floating charges.

Group 14 — Floating charge — Companies and others

16.14.1 to 16.14.3 I refrain from answering these questions because of lack of knowledge of the law of India concerning floating charges.

Group 15 — Floating charge — Agricultural Credits Act, 1928 of U.K.

16.15.1 to 16.15.4 I refrain from answering these questions because of lack of knowledge of the Agricultural Credits Act, 1928.

Group 16 — Floating charge — Registration

16.16.1 I refrain from answering this question because of lack of knowledge of the practice under the Registration Act.

Group 17 — Pledge — Documents of title to goods

16.17.1 I refrain from answering this question because of lack of knowledge of the law of India concerning the pledging of documents of title.

16.17.2 It would facilitate the pledging of goods by lodging the relevant document with the lender as security for a debt if the definition of "document of title" should be broadened to include receipts issued by carriers. Cf. the definition of "document of title" in section 1-201(15) of the UCC.

Group 18 — Pledge — Shares

16.18.1 I presume that a "mortgage of shares" refers to an arrangement under which the share certificates are retained by the mortgagor and is an hypothecation. This has been possible under U.S. law, both before and after the UCC, only in very rare situations, such as a delivery of the share certificates to a debtor in order that they may be exchanged for other certificates. Cf. UCC section 9-304(5)(b). In my judgment, shares should be pledged rather than mortgaged or hypothecated.

16.18.2 I do not consider that ordinarily a pledgee of shares who permits them to continue to be registered in the name of the pledgor should have his claim extended to dividends, rights and bonus shares unless (1) the agreement of pledge so provides, or (2) the shares are registered in the name of the pledgee.

Group 19 — Pledge — Stock-in-trade

16.19.1 An arrangment such as the one described in the question could be ranked as a pledge or hypothecation if the goods are truly under the sole and exclusive control of the bank and its watchman; but it could not be if the borrower retained the keys for any purpose. The former method is known in the U.S.A. as "field ware-housing".

16.19.2 I do not know what difficulties have been experienced in India, but in the U.S.A. the bank could not recover the goods in the event of the borrower's bankruptcy, nor could it recover them from another person who had no knowledge of the earlier pledge if the borrower should fraudulently make a further pledge of them.

16.19.3 I am not asked to answer this question.

16.19.4 I am not sufficiently familiar with the "floating charge" referred to in this question to be able to distinguish it from the pledge of specific assets left in the borrower's business premises. The English "floating charge" differs from the UCC "floating lien". I believe the latter differs from a pledge of specific assets left in the possession of the borrower only in the extent of the bank's lien, and public notice of each must be given by the filing of financing statements.

Group 20 — Pledge — Registration

16.20.1 I reach a point at this question where I no longer understand how the terms "pledge" and hypothecation are being used. In the absence of registration or filing, the number of situations where the borrower should be allowed to deal with the goods should be very small, and probably should be limited to those described in subsection 9-304(4) and (5) of the UCC, where the period is short and the purpose is specified. It should be remembered that in most cases, neither registration nor filing will always protect the lender against fraud, because by the time he has learned what has occured, the property subject to the pledge will usually have vanished. What the lender needs is protection against the borrower's financial distress or insolvency, and this can be given to him where he releases the assets for a limited time for a specified purpose.

16.20.2 I favor the same provisions for both company and other borrowers.

Group 21 — Trust receipts — Nature of

16.21.1 I suggest the rights of the lender who parts with pledged goods against trust receipts can best be protected by the enactment of new legislation similar to the UCC.

16.21.2 The term "trust receipt" is a misnomer. There is no trust. However, the term is now so well established in financial circles that a change in its use would be confusing. But it should not be taken literally in making a legal analysis. It should create a security interest in or a charge on property and the relative advance should be treated as secured.

16.21.3 A change should be made in India so that goods covered by a trust receipt are not affected by the reputed ownership clause.

16.21.4 Goods and documents of title released against trust receipt are not trust property, in any proper sense of the word "trust". They differ greatly from goods bequeathed by will or granted by an indenture of trust to a trustee to hold for a beneficiary. The goods are merely subject to an encumbrance, lien, charge or security interest.

16.21.5 I do not believe lending institutions need protection against an unauthorized pledge of documents of title released to a borrower against a trust receipt. Many borrowers suffer financial reverses and become insolvent. Lending institutions need protection where this occurs. But in my own experience, few of these borrowers are dishonest. It is more important to permit documents of title to be freely negotiated than to protect lenders against dishonesty of their borrowers.

16.21.6 In the few cases of dishonest borrowers, criminal proceedings should be made possible.

Group 22 — Trust receipt — Legislation in U.S.A.

16.22.1 In my judgment, legislation to provide for the spread of the use of trust receipts would be desirable for India, but it would be preferable to incorporate such legislation in a more comprehensive code relating to all banking and commercial law.

Group 23 — Trust receipt — Special legislation

16.23.1 I see no necessity of confining legislation concerning trust receipts to banks and other financial institutions.

16.23.2 Legislation concerning trust receipts should provide for the matters specified in the section.

Group 24 — Comprehensive scheme of legislation regarding charges on movable assets

16.24.1 I do consider it desirable to have the rights of the parties to a secured transaction determined mainly by the substance of the transaction.

16.24.2 I believe it would be desirable for India to have a unified scheme relating to charges over movable assets similar to the UCC.

Recently the Uniform Commercial Code has had very deep study in England, by the Committee on Consumer Credit under the chairmanship of Lord Crowther. In its report, known as the "Crowther Report", the Committee stated "In the paragraphs that follow we have drawn heavily on Article 9 of the American Uniform Commercial Code to which reference has been made in paragraph 5.1.5. This represents the distilled wisdom and knowledge of a great number of lawyers and others concerned in the field of personal property security and we imagine that few, if any, enactments or model laws have been submitted to such critical and prolonged analysis during the drafting stages. Article 9 deserves the closest scrutiny by all those concerned with the modernization of British personal property security law. * * * we consider that Article 9 is in concept and structure an admirable prototype for a modern law of personal property security." (Crowther Report, Section 5.5.6).

"The Code has now been adopted in every state except Louisianna. This is a remarkable tribute to those responsible for producing it; and the wide-spread adoption of the Code appears to be due in no small measure to the outstanding merits of Article 9, which gave the common law world, for the first time, a comprehensive and rational legal structure for the regulation of security interests in personal property. We have been much influenced by the underlying concepts of Article 9 which is referred to in other passages of our report." (Crowther Report Section 5.2.9).

"An excellent example of the manner in which such a unified system can be constructed is Article 9 of the American Uniform Commercial Code, to which reference has previously been made. It forms the basis of much of the thinking underlying this part of our report. The impact of Article 9 is not limited to the United States,

but already has resulted in the enactment of the Ontario Personal Property Security Act, 1967, which is substantially modeled on it. Article 9 has also attracted widespread interest in Australia and New Zealand." (Crowther Report Section 5.2.9).

16.24.3 I consider it desirable to have a scheme of legislation determining the rights of parties essentially having regard to the criteria set forth in this question.

16.24.4 I would have such a legislative scheme cover all of the types of transactions set forth in this question.

16.24.5 I believe it would be desirable to evolve a scheme of registration of charges in India similar to the provisions of the UCC.

Group 25 — Special provisions for banks

16.25.1 to 16.25.5 I refrain from answering these questions because of lack of knowledge of conditions in India.

PART 17 — CHARGE ON FIXTURES

Group 1 — General

16.25.1 I refrain from answering these questions because of lack of knowledge of conditions in India.

Group 2 — Distinction between movable and immovable assets

17.2.1 The question whether machinery and other like assets used as security for advances are movable or immovable is often very difficult of determination.

17.2.2 I believe that the rights and obligations of the parties while making advances against fixtures must depend on whether the assets are "movable" or "immovable".

17.2.3 I believe it would be desirable to determine the rights and obligations of parties in India who deal with finance against fixtures without reference to the question of whether the fixture is to be regarded as a movable or an immovable asset. It should be remembered, however, that the present provisions of the UCC have been substantially revised by the Permanent Editorial Board for the UCC, and are now set forth in the 1972 Official Text. The revised provisions concerning fixtures are discussed at some length by the writer of these answers in articles which appeared in 26 The Business Lawyer 1465 (July, 1971) and 27. The Business Lawyer 321 (November, 1971). xx xx xx xx These articles cover many other proposed changes in the UCC. The revised provisions have been adopted by the State of Illinois, and are under consideration in many other states.

Group 3 — Charges on machinery, etc. which subsequently become fixtures

17.3.1 I do not consider that the mode of creation of a charge over machinery or other like goods should depend on whether or not such asset is subsequently going to be a fixture or an immovable asset. In fact, machinery should never be an immovable asset, as I understand that term. The only goods which, as I view it, should be regarded as immovable assets are ordinary building materials incorporated into a structure, such as lumber, bricks, etc.

17.3.2 I refrain from answering this question because of lack of knowledge of the present law of India about fixtures, and whether clarification is needed.

17.3.3 I believe it would be desirable to provide in India that a secured claim over machinery or other like goods is not affected by reason of the fact that such asset has become a fixture or an immovable asset.

Group 4 — Priority as to fixtures

17.4.1 I refrain from answering the question because of lack of information of the present law of India about fixtures, and whether clarification is necessary.

17.4.2 I favor a general provision that a charge on machinery or other like goods, which attaches before they become fixtures, generally takes priority over all persons having an interest in the real estate.

17.4.3 I feel it is desirable to provide that a charge over machinery or other like goods created after they become fixtures is generally valid against persons acquiring an interest in the real estate subsequent to the creation of the charge, but not against any person already having an interest unless he acquiesces by consent or disclaimer.

17.4.4 I favor the substance of the UCC with regard to priority over subsequent purchasers, lien creditors and creditors with a prior recorded encumbrance who make further advances. However, I consider the proposed new provisions of Section 9-313 (now in effect in Illinois) far superior to those of the 1962 Official Text, which is in effect in most other states.

Group 5 — Fixtures — Rights of a charge holder

17.5.1 I consider that where a lending institution obtains a charge on machinery or other like goods it should have the right of removing the fixture from the real estate, and that there should be a specific provision along these lines.

17.5.2 I consider it desirable to have a provision in India substantially similar to section 9-313(5) of the UCC.

17.5.3 I do not consider it desirable to provide that the lending institution against a fixture have precisely the same rights as are allowed if it were advancing against a movable asset. In particular it should be required to pay the cost of repairing any physical injury to the real estate caused by the removal of the fixtures.

Group 6 — Fixtures — Registration of charges thereon

17.6.1 I consider it necessary to provide for a scheme of registration of charges over the fixtures, whether they are part of the real estate or not.

17.6.2 I consider it necessary to provide in India that a charge on a fixture is ordinarily perfected only if it is registered.

17.6.3 I refrain from answering this question because of lack of knowledge concerning registration of charges in India.

17.6.4 I would favor the reduction to a minimum of the cost of registering charges on fixtures. However, the cost of such registration may need to be higher than the cost of registering charges on movables. Such a difference is permitted by revision of Article 9 proposed by the Review Committee.

Group 7 — Charge on fixtures vis-a-vis special provisions in favor of cooperative banks

17.7.1 I refrain from answering this question because of lack of knowledge concerning cooperative and land development banks in India.

Group 8 — Uniform legislation to cover also fixtures

17.8.1 I consider it desirable for a scheme of legislation covering charges over movable assets to cover also fixtures, whether they are regarded as movable or immovable assets.

REPLIES OF MR. MAURICE MEGRAH,* Q.C., TO THE QUESTIONNAIRE RELATING TO THE LAW IN REGARD TO LOANS AND ADVANCES BY BANKS AND OTHER FINANCIAL INSTITUTIONS — CHARGE ON MOVABLE ASSETS

PART 13 — LOANS AND ADVANCES BY BANKS — GENERAL

Group 1 — Vis-a-vis the law in other countries

13.1.1 and 2 — I do not see any necessity in principle for the law relating to advances by banks in India to be in line with that of other developed countries; this depends largely on the psychology of the people and their needs. However, having in mind that banking in India is to some extent similar to that of the United Kingdom it would seem to be a difficult matter and, perhaps, unprofitable to attempt to reverse the position. It seems to me that the answer to this question must depend on the needs of the population; when these are appreciated the best of a choice of alternatives will probably clearly emerge.

13.1.3 (a), (b) and (c) — I regret that I cannot answer this question without knowing more of conditions in India. As regards (c) I see no reason for a limit; normally the lending bank is the best judge, but it might be wise to restrict this lending to certain classes of banks.

Group 2 — Special provisions relating to financial institutions

13.2.1 (a) and (b) — Lending to cooperative credit societies and institutions for land development is specialised and accordingly subject to special conditions, which are not necessarily applicable to banks and finance houses. Any extension of the principles by which the former are governed would hardly be suitable to the latter.

13.2.2 — I do not know the special conditions referred to, but the answer would seem to be the same as that to 13.2.1.

PART 16 — CHARGE ON MOVABLE ASSETS

Group 1 — General

16.1.1, 2 and 3 — I think it can be said that the law relating to pledge in the United Kingdom works satisfactorily, but if it is thought desirable in India to legislate, then the U.C.C. (perhaps with modifications to meet Indian conditions) would serve as a basis.

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*Editor of Paget's "Law of Banking", Byles "Bills of Exchange", Gutteridge's "The Law of Bankers' Commercial Credits" and the "Legal Decisions affecting Banking" published by the Institute of Bankers, London.

Group 2 — Hypothecation — Nature of

16.2.1 The charging of goods by deposit of the documents of title gives a valid pledge which, so long as the lending banker has control (whether the goods are represented by bills of lading or are attorned to the banker) cannot be overridden. Hypothecation arises where a charge over goods is given but the bank has neither documents of title nor the goods themselves and this is the sense in which I use the term from now on. This is clearly an equitable charge and may never become effective. If a charge is given over goods which remain in the borrower's possession, it is a bill of sale, if the borrower is not a company.

16.2.2 An equitable charge may, in my view, be a hypothecation as above or a charge over goods in a warehouse not attorned to the lending bank. This may, as I have said, be entirely ineffective. I am not sure that it is right to say in the second case — or even the first, if the goods are in existence — that the charge conveys no interest; I think that it conveys no enforceable interest.

Group 3—Hypothecation and future advances

16.3.1 and 2 I am not sure of the reason behind this question. The advances made against goods must depend, inter alia, on the value of the goods and on the substance of the borrower. Any ceiling must be arbitrary.

Group 4 — Hypothecation — After acquired property

16.4.1, 2 and 3 By 'after-acquired' property is meant, I take it, future goods covered by a letter of hypothecation and assets covered by a company floating charge. There is very little difficulty in the United Kingdom in this matter. I have not had the chance of looking at *Re Ambrose Summers*. Otherwise it is not normal to provide that a charge shall cover any assets acquired by the borrower subsequent to the charge unless they flow from the charged property itself. But there would seem to be no reason why the borrower should not contract regarding property he may acquire in the future — though the security is obviously somewhat nebulous. As regards 16.4.3 I have no sufficient knowledge.

Group 5 — Hypothecation — Enforceability against third parties

16.5.1 I would have thought it impossible for third parties to be notified of a bank's interest in future goods — the goods may never come into existence. A letter of hypothecation normally extends to documents or goods which come into the possession of the bank. A bank should, and will normally, not lend unless it is satisfied both as to the security offered and the substance and integrity of the borrower.

If the term 'hypothecation' is intended to apply to a pledge or charge over actual, existing, assets the bank would have control over them save in the case where the charge is a floating charge; and save in the case of company charges no registration is necessary.

16.5.2 Any lender to a company should search the register before lending.

16.5.3 This must be peculiar to India. I imagine that registration is essential in the case of companies and thus I do not see how borrowing companies can "effectively create a charge over their stock-in-trade at low cost".

16.5.4 I am not sure from the question whether it is proposed to require registration in all cases but, if it is, it would probably be necessary to enact that registration is notice to the whole world.

16.5.5 Unless registration were universally required the system would be ineffective, but to require universal registration would entail a costly organisation largely for the benefit of classes of the community which should know how to look after themselves.

16.5.6 The United Kingdom Bills of Sale Acts do not affect pledges or charges where the goods are delivered into the control of the lender and very few assets other than commodities are affected.

16.5.7 A written instrument has the advantage that it speaks for itself and does not normally permit of contradiction.

16.5.8 I am not in favour of a scheme for registration of charges over movable assets, but I cannot speak for India. See the answer to 16.5.5.

Group 6 — Hypothecation — Enforceability against Official Assignee/Receiver

16.6.1 Unless the banker has a charge or bill of sale over assets in the possession of an insolvent borrower he can have no priority and the charge or bill of sale must be registered to give him a security.

16.6.2 and 7 A letter of hypothecation in England is not synonymous with a trust receipt, the latter properly arising only where a banker with a pledge releases the goods in trust. The reputed ownership clause does not in the United Kingdom apply to limited companies and a letter of hypothecation would not cover goods in the possession of a private borrower unless it were a bill of sale.

16.6.3 and 4 This question, I think, refers to the case where goods are in the premises of the borrower but not in his control, the banker having the key to the premises and controlling them as if they were his own. This is a case of pledge and reputed ownership does not arise.

16.6.5 The tendency referred to has been encouraged by the increase in the number of company borrowers and in the information available to lenders and merchants generally regarding people with whom they deal. It may well be that in India the number of non-company borrowers and merchants is relatively much greater, in which case the retention of the reputed ownership doctrine may be desirable.

16.6.6 and 7 If banks lend against movable goods they should either have the documents of title covering the goods or have the goods attorned by the custodian. If the goods remain in the possession and control of the borrower, not being a company, the bank may not have an adequate security and there is always the risk that the goods may be dealt with before the loan is called in or the borrower becomes bankrupt. I see no reason for any change if the law in India is much the same as that of the United Kingdom.

16.6.8 I do not know the law in India, but see 16.6.2.

16.6.9 Not if the assets remained in the control of the borrower.

Group 7 — Hypothecation — Motor vehicles

16.7.1 to 5 I have had no experience of lending against motor vehicles.

Group 8 — Hypothecation — Stamp duty

16.8.1 and 2 I do not know what is meant by an 'attested' instrument, but this question depends upon conditions in India.

Group 9 — Hypothecation — Priorities

16.9.1 and 2 The person in possession and control of the assets should have priority. As between subsequent charges the date of registration of the charge, or the date of its creation if there is no provision for registration, should determine priority.

16.9.3 I do not know what are the other types of charge referred to.

16.9.4 This question depends upon whether there is a system of registration and its legal effects or, if not, how priorities are otherwise established. I have been unable to read the Indian decisions referred to. I am still confused as to the sense in which the term 'hypothecation' is used. But see 16.6.6.

Group 10 — Hypothecation — Proceeds

16.10.1 I do not know, but if the lender has a proper security he must (or should) have a prior claim pro tanto to the proceeds.

16.10.2 This probably depends upon the terms of the document of charge.

16.10.3 This question seems to suggest that the assets referred to are in the control of the borrower. It is an unsatisfactory security except where the borrower is of the highest integrity, as where goods are released pursuant to a letter of trust, in which case the security extends to the proceeds, but notice of the pledge should be given to a purchaser from the borrower, if he is known to the lender.

16.10.4 This is a difficult question and may raise questions of conflict of interest which would be hard to solve. The security cannot become part of a product or mass unless delivered in trust to the borrower; in such circumstances the lender should ascertain how the goods were being dealt with, who was to receive them for manufacture, whether the borrower or someone else would dispose of them for manufacture, and take an assignment of the proceeds of sale to the extent of the advance. The banker would then give notice to the appropriate party, the party selling, to whom the proceeds would be payable.

Group 11 — Hypothecation — Rights of a hypothecatee

16.11.1 and 2 I assume that for purposes of Group 11 'hypothecatee' means a lender who has some sort of charge over goods not in his possession or control. In such a case the borrower cannot easily be prevented from dealing with the goods as he pleases. Whatever his

rights the hypothecatee may find his 'security' gone or taken in liquidation for the benefit of the borrower's creditors generally and that there is nothing left but a right of proof in the liquidation. If the borrower is a company a floating charge debenture would, of course, give the lender a security in the event of liquidation.

16.11.3 and 4 I cannot answer these questions. The situation referred to is one of which I have no knowledge. But if the banker obtains a valid charge from a company and the asset can be identified, the bank may apply to the Court for the appropriate order enabling the bank to deal with the security.

16.11.5 I do not understand this unless the lender has a floating charge which has crystallised on the borrower's liquidation and the assets referred to fall within the floating charge.

16.11.6 This is usually provided for in the charge.

Group 12 — Floating charge over moveables — Nature of

16.12.1 I understand that in India the law makes no distinction between legal and equitable *estates* (16.2.2). I do not know if there is any difference between a legal and an equitable *charge*, but it seems to me that a floating charge must be an equitable charge until it crystallises, when it becomes specific and legal if the deed under which it was given so provides.

16.12.2 A lender always has a personal right against a borrower for the latter's debt, but as regards property subject to a floating charge he can have no specific rights until the charge crystallises for until then the borrower is free to do as he likes with such assets. Before bankruptcy or liquidation the lender can have no specific rights unless they are given to him in the charge and the circumstances in which they take effect have happened, such as the calling in of the loan. And the charge can cover only such floating assets as are in being at that time; but the bank has always the right to sue for the debt

Group 13 — Floating charge — How determined

16.13.1 Mostly, in the case of company borrowers, by means of a debenture; in the case of non-company borrowers, by a charge which states the security but leaves the control of it with the borrower.

16.13.2 Normally, yes.

16.13.3 If by hypothecation is meant what I assume in 16.11.1, yes.

Group 14 — Floating charge — Companies and others

16.14.1, 2 and 3 I see no reason why a non-company borrower should not give a floating charge over his assets, but this would be a bill of sale and subject to the rights of the Bills of Sale legislation; in practice it would be virtually ineffective. A floating charge is something more than a 'personal' right; it is a right of security if the floating assets are there when the charge crystallises.

It is usual to take a charge which embraces specific charges as well as a floating charge and it must be registered. But so far as the floating assets are concerned the position of the lender depends upon what there is when the charge crystallises; registration of the charge makes no difference to this. Even if a floating charge alone were taken, registration would merely have the effect of putting any other lender on notice, but it would not affect his taking a specific charge over any of the floating assets and such charge would take priority over the floating charge.

Group 15 — Floating charge — Agricultural Credits Act, 1928 of U.K.

16.15.1, 2, 3 and 4 I believe that the United Kingdom Agricultural Credits Act, 1928 works well enough but whether it would be suited to Indian conditions I cannot say.

Group 16 — Floating charge — Registration

16.16.1 If a floating charge is given by a company it should be registrable in the company charges register; if by an individual or partnership (assuming that this has any value at all) pursuant to the Bills of Sale Acts.

Group 17 — Pledge — Documents of title to goods

16.17.1 I would have thought not, if the documents of title were per se such as to pass title. I have not read the *Mercantile Bank* case.

16.17.2 The lodging of such documents as truck receipts is of little effect unless the goods are attorned to the bank — which may not be possible. Apart from attornment I see no way in which such documents can pass title.

Group 18 — Pledge — Shares

16.18.1 In a pledge, the goods themselves are delivered to the banker, who obtains possession and a special title; in the case of a mortgage of property possession is still in the mortgagor, who has a right to redeem; unless the subject of the mortgage, if shares, is transferred into the name of the mortgagee who is entered in the share register, the legal title is still in the mortgagor.

16.18.2 This is usually done by the charge.

Group 19 — Pledge — Stock-in-trade

16.19.1 This is merely a method of obtaining a pledge, by obtaining possession and control. If it is essential that such goods should be processed and that the borrower be given access to them, this should be done by a letter of trust constituting the borrower the agent of and trustee for the bank.

16.19.4 There is no material distinction between the two. Is it necessary to distinguish them; the right of the owner of the goods is the same in each case, but the right of the bank would in each case depend upon the construction of the pledge or charge.

Group 20 — Pledge — Registration

16.20.1 and 2 In the case of a pledge, the goods or the documents of title are delivered to the lending banker; they may be released in trust to the borrower without the banker's losing his pledge. In a hypothecation, the bank has neither possession nor property in the goods until they are in existence and normally not then unless they are delivered to the bank (in which case the hypothecation becomes a pledge) or they are retained by the borrower under what is virtually a bill of sale. In both cases the value of the Bank's security depends upon the integrity of the borrower, except where the doctrine of reputed ownership operates to the detriment of the banker. I do not consider that registration of pledges is necessary or even desirable.

Group 21 — Trust receipts — Nature of

16.21.1 and 5 If decisions of the Courts in India have rendered delivery of goods under trust receipts destructive of the pledge on which the receipts are based, only a decision of a higher court or legislation can set the matter right. I know of no means by which the lender can be protected if the borrower is dishonest. The banker must know his customer or suffer if the customer is dishonest.

16.21.2 I suspect that the instruments in the *Mercantile Bank* case were not trust letters such as are used where documents of title are returned in trust to the borrower; but I do not know Indian trust receipts or how they are issued.

16.21.3 I am inclined to think that the United Kingdom law is better. It is to be remembered that this is not simply a case of a charge over goods in the possession of the borrower, but of the re-delivery of goods, subject to a pledge by the borrower, to the borrower or to someone else at his direction. They are delivered to him as the agent of and trustee for the bank for a specific purpose. It seems to me that the Indian law may operate to deny the efficacy of trust letters.

16.21.4 I do not know what is necessary in Indian law for the creation of a valid trust or how, if redelivery of goods to a borrower-pledger pursuant to or evidenced by a letter of trust is not sufficient, a valid trust can be created.

16.21.6 Goods are released under a letter of trust which renders the borrower the trustee for the lender and for the specific purpose of selling the goods. If the borrower defaults he is surely liable for breach of trust and, perhaps, guilty of fraud. If he accepts redelivery on the understanding that the proceeds of the sale of the goods are to be handed to the bank and he fails to do so he may well be guilty of fraud.

Group 22 — Trust receipt — Legislation in U.S.A.

16.22.1 I do not know how much trust receipt law there is in India which might be codified. If there is a great deal and it is complicated codification might perhaps be a good thing. But at the moment I see no necessity for it.

Group 23 — Trust receipt — Special legislation

16.23.1 and 2 I do not see how the trust receipt facility can be made more acceptable by legislation, except possibly if it were enacted that the normal letter of trust does create a trust and that neither the goods subject to it nor the proceeds of sale are subject to the reputed ownership doctrine.

It is obvious from question 16.23.2 that trust receipts may be used more widely elsewhere than in the United Kingdom and it seems to me that there may be a danger in attempting to use for other purposes, other 'financial' transactions, a means by which a lending banker retains the rights he obtains by a pledge of goods. A mere admission by a borrower that he holds goods in trust for a banker, in circumstances in which the banker has never had either the goods or the documents of title is a doubtful security and could conceivably be ineffective against a trustee in bankruptcy or a liquidator.

Group 24 — Comprehensive scheme of legislation regarding charges on movable assets

16.24.1 I would have thought it preferable that the rights of the parties to any contract should be determined by the terms of the contract or the document evidencing it. What such document should include must depend upon the wishes of the parties, but the document will, of course, be construed according to the law of contract and any other relevant law. The question of registration and priority is ancillary. What is important, I think, is that the borrower should understand what he is signing and no law will help him if he does not.

16.24.2, 3 and 4 I think that I do not altogether understand Article 9 of the UCC, but it is obvious that the rights of parties will differ according as the criteria mentioned in 16.24.3 are present or not — though I do not appreciate the distinction in (c). This seems to me, however, not to be essentially a matter of legislation, but of the particular contract into which the parties enter and the law (not necessarily statutory) governing it.

I do not know how well Article 9 works but I would have thought that it attempted to lay down too much, if it purported to cover the types of transactions set out in 16.24.4, with the possible exception of (f), which range over an infinite variety depending upon the wishes of the parties superimposed on the basic contract.

16.24.5 I take it that this refers to charges over goods which remain in the control of the borrower. I am not sure if there is any distinction between this and bills of sale in the United Kingdom. If India has no similar legislation I would think that there is a case of introducing it, for such charges are in the majority of cases, probably, given by individuals.

Group 25 — Special provisions for banks

16.25.1 and 2 I would not think it necessary or desirable, providing that the bank can obtain a proper security otherwise. Is it suggested that because cooperative societies have a statutory first charge that no other bank

can have a similar charge? Cooperative banks are often restricted in their activities and functions, and what may be essential in their case is not necessarily essential to banks generally; but obviously any bank should be able to secure itself adequately — which means in the same way, though not statutorily.

16.25.3 I think that any other bank should have the same right as a cooperative bank or, shall I say, I see no reason why it should not unless it is desirable to restrict agricultural lending to cooperative societies.

16.25.4 If the security consists of land or any property not essential to the agriculturists' farming, the bank should be able to control it — in the case of land by taking deposit of the title deeds, in the case of shares by taking the share certificate and in the case of other choses in action or of movable property by whatever means is appropriate.

16.25.5 See my answer to 16.24.5. In any other case than that of property remaining in the control of the borrower, no registration should be necessary providing the bank can take a security in such form that no third party can obtain an overriding security.

PART 17 — CHARGE ON FIXTURES

Group 1 — General

17.1.1 If the machinery is movable, taking it as a security should be no different from any other of which the borrower remains in control. If it is a fixture it should go with the property to which it is affixed and it does so in the United Kingdom.

Group 2 — Distinction between movable and immovable assets

17.2.1 I think that the distinction is not easy to determine, but when there is doubt it would be preferable to treat the machinery or other asset as movable and to take a specific charge with an undertaking by the borrower not to dispose of it without the bank's consent, registering the charge.

17.2.2 and 3 I do not think that the rights of the parties should depend upon a Court decision whether a security is movable or immovable. It should be possible to frame a charge so as to give the bank a good security in either case, provided the borrower is a person of integrity. If he is at all doubtful or is likely to become so in an emergency the bank should not take the asset as a security.

Group 3 — Charge on machinery, etc. which subsequently become fixtures

17.3.1, 2 and 3 Whether the asset is deemed movable or immovable, a charge can be devised to cover it. If the borrower agrees to treat the asset as immovable and is to be relied upon, a specific charge can be taken which provides that the borrower will do nothing with the machinery (except use it) without the consent of the bank. Whether this will be satisfactory to the bank must depend on the amount of the advance sought in relation to the security other than the 'doubtful' asset. But if the bank is to depend upon this asset it would be wise

to treat it as movable, take a floating charge and register it if registration is possible. If the asset subsequently becomes immovable the bank should take a further specific charge, for which the floating charge should provide.

I suppose that 17.3.3 means that when an asset subject to a floating charge (in the belief that it is movable) becomes a fixed asset, the charge crystallises into a fixed charge. As I have said the point can be covered by a fresh charge or the floating charge may provide that upon an asset deemed movable becoming immovable it shall automatically become subject to a specific charge.

Group 4 — Priority as to fixtures

17.4.1 I imagine that in most cases the two charges would be the same, but I suppose that a bank might lend against the immovable structure and the fixture might be the subject of a hire-purchase agreement. In such a case the bank's security would be unaffected except that it could not look to the fixture if it had notice of the hire-purchase agreement. I doubt if statutory definition would do any good.

17.4.2 In the United Kingdom a bank would not lend to a manufacturer against machinery which was destined to become a fixture in a third party property before the loan could be repaid. The bank would expect the advance to be repaid before or when the machinery was sold. The rights of the real estate owner must be kept distinct from those of the bank lending against machinery — in the sense indicated above.

17.4.3 and 4 Machinery becoming a fixture becomes part of the property to which it is attached. If this property is unencumbered the bank will be safe in lending against it or against the machinery; but if the property is subject to a charge it is unlikely that any bank would lend against the machinery except with the land chargee's consent. To legislate would, I think, be undesirable.

If a charge on the machinery is to take priority over a charge on the property to which the fixture is attached, it can, it seems to me, only be with the approval of the latter, for the charge over the fixture cannot give any right over the property to which the fixture is attached; yet to deal with the fixture by itself would probably be impossible. It would seem that a banker should not lend against a fixture alone but only as part of a larger security which embraces the property. He should require repayment when the machinery becomes a fixture unless he obtains the property as well as security

Group 5 — Fixtures — Rights of a charge holder

17.5.1 and 2 If the machinery can be removed from the property to which it is affixed it is probably not a fixture and the lending banker should be able to sell if his charge gives him power. I would think it most difficult to legislate as is suggested in 17.5.2 and I would think that the consequences visualised would follow in any event.

17.5.3 If the fixture is immovable without damage to the property to which it is affixed it can hardly be regarded as a movable asset, in which case the rules as to charges over movable assets would not apply.

Group 6 — Fixtures — Registration of charge thereon

17.6.1, 2 and 3 If machinery et cetera is not a fixture, if it can without damage be separated from the building in which it is placed, either a specific or floating charge can be taken; but as it remains in the control of the borrower-owner the charge should be registered either under the equivalent of the United Kingdom Bills of Sale Act or pursuant to the Indian companies legislation. There would seem to be no necessity for double registration.

17.6.4 This is partly a fiscal question but, apart from this, I would think it desirable to keep cost to a minimum.

Group 7 — Charge on fixtures vis-a-vis special provisions in favour of co-operative banks

17.7.1 No bank would ordinarily lend against a fixture in a property on which it had no charge; when it did so lend, it would be because it was satisfied as to the circumstances. I would accordingly not think it necessary or desirable to ensure that a charge on fixtures took priority.

Group 8 — Uniform legislation to cover also fixtures

17.8.1 See my comments to 17.5.1 and 2.

ANNEXURE 7

BANKING LAWS COMMITTEE

(Government of India)

PROJECT STUDY ON PERSONAL PROPERTY SECURITY LAW

Project Report

Introductory

The Banking Laws Committee is engaged in simplifying, rationalising and modernising the credit and commercial laws of our country, which affect banking. In this important task, the Banking Laws Committee has to review the areas where legislation may be urgently required in the field of advances against goods, fixtures, inventories, documents of title, negotiable and non-negotiable instruments, accounts receivables and other intangibles, which may be stated shortly as advances against personal property. This field covers personal property security law in general and as it affects banks and other financing institutions. It also covers the special aspects pertaining to consumer credit legislation. In these areas legislation in our country is not yet developed.

2. The Banking Laws Committee is aware of the several recent developments in Common Law countries, particularly, the U.S.A., Canada, the U.K. and Australia, for the reform of the personal property security law and the law relating to credit. The Banking Laws Committee is also aware of the several areas of ambiguity and the inhibiting factors in those areas. The questionnaire circulated by the Banking Laws Committee has drawn pointed attention to many of the problems connected with personal property security law. Hence, in order to promote an in-depth study with a view to recommending appropriate solutions to the problems and in this process to evolve statutory schemes in India to regulate transactions secured by personal property and consumer credit, the Banking Laws Committee wanted to sponsor a project with the approval of the Government of India.

3. For the above purpose, the Chairman of the Banking Laws Committee, Dr. P. V. Rajamannar, Retd. Chief Justice of Madras, wrote to Prof. R. C. Mehrotra, Vice-Chancellor of the University of Delhi, and obtained the permission of the University for involving some members of the Faculty of Law of the University in the project to be carried out jointly by such Faculty members and the Secretary of the Banking Laws Committee, Shri R. Krishnan, who was nominated for this purpose by the Banking Laws Committee. Subsequently, he has also taken up the matter with the Central Government and obtained the clearance of the Government for the project.

4. Earlier, Dr. K. B. Rohatgi, Dean, Faculty of Law (now Director, South Delhi Campus of the University of Delhi) and Shri Krishnan did the spade work for launching the project. In addition to Dr. Rohatgi and

Shri Krishnan, the Project Team comprised Dr. K. Ponnuswamy, Reader, Faculty of Law, Dr. B. Sivaramayya, Reader, Faculty of Law, and Shri K. K. Puri, Lecturer, Faculty of Law.

5. Since Shri Puri left for Australia, he could not be associated with the Project Team, except in the preliminary meetings.

6. The Project Team met on the following dates :

5th April	1975,	10th October	1975,
29th April	1975,	11th October	1975,
30th April	1975,	13th October	1975,
20th May	1975,	15th October	1975,
21st May	1975,	3rd May	1976,
22nd May	1975,	4th May	1976,
23rd May	1975,	5th May	1976,
16th August	1975,	6th May	1976,
17th August	1975,	7th May	1976,
*3rd September,	1975	17th May	1976,
*4th September	1975,	18th May	1976,
*5th September	1975,	19th May	1976,
1st October	1975,	20th May	1976,
2nd October	1975,	21st May	1976,
3rd October	1975,	24th May	1976,
6th October	1975,	25th May	1976,
8th October	1975,	26th May	1976,
9th October	1975,	27th May	1976, and
		31st May	1976.

7. In connection with the project work, Dr. Rohatgi and Shri Krishnan met and had discussions with the Chairman, Banking Laws Committee, on 31st May 1975, at Madras.

8. On behalf of the Chairman, Banking Laws Committee, Shri Krishnan and Dr. Rohatgi had discussions with the Hon'ble Deputy Minister of Finance, Shrimati Susheela Rohatgi, on 16th and 18th September and on 16th October 1975 and obtained the benefit of her guidance, *inter alia*, regarding the nature and scope of the project work.

9. The relevant materials, memoranda and data which the Banking Laws Committee had collected were made available to the Project Team and this enabled the Project Team to appreciate the areas where in its practical working the existing state of the law is coming in the way of banks, financing institutions, industry and trade effectively utilising the raw materials, inventories, accounts receivables, etc., as security for credit. The Project Team received valuable assistance from the comparable models already

*Dr. Sivaramayya could not attend the meetings held on these dates as he was then abroad.

developed in the U.S.A. and in Canada, and from the writings of experts like Mr. Carl W. Funk of the U.S.A. and Prof. R. M. Goode of the U.K. Mr. Carl Funk and Mr. Maurice Megrah, Q. C., of the U.K., had answered, *inter alia*, the related Parts of the questionnaire which the Banking Laws Committee had circulated. The officers and the other staff of the Banking Laws Committee provided active help and assistance to the Project Team in its work.

Personal Property Security Law and Consumer Credit.

10. As originally planned, the Project Team was to cover not merely the area of the legal regulation of credit against personal property security in general, but also to consider the special aspects of consumer credit. However, as the study progressed, it was realised that the problems relating to personal property security in general should first be tackled before the Project Team could take up the special aspects of consumer credit. Accordingly, in this study we have confined ourselves mainly to a review of the legal infrastructure governing credit transactions in general against personal property security. However, as a result of this review, we have found it necessary to suggest some changes to the scope of the Hire-Purchase Act, 1972, which is a form of consumer credit legislation and which is yet to come into force. But for this limited change which we have found necessary to suggest in order to give effect to our suggestions for the main scheme of the reform of the personal property security law, we have not gone into the special aspects relating to consumer credit.

Our general approach

11. In our study we have considered the recent developments in other countries and the sweeping trend for legal reform in the field of personal property security law. This trend has gained momentum from the formulation, for the first time, of a conceptual scheme regulating all personal property security interests having regard to their substance and without any undue emphasis on their form. This break-through in legal reform was first achieved in Article 9 of the Uniform Commercial Code of the U.S.A. The scheme of Article 9 has come in for a great deal of appreciation and critical study by experts in many Common Law countries, particularly, the U.K., Canada and Australia. In Canada, the Canadian Bar Association has come forward with a model for legislation suitably adapting the provisions of Article 9 for legislation by the Provinces of Canada. Several Provinces of Canada have enacted legislation based on this model, and the legislation in the Province of Manitoba is of the year 1973. The Crowther Committee, which was appointed in the U.K. mainly to go into consumer credit, had also felt impelled to recommend for the U.K. an enactment of a scheme similar to Article 9 to regulate transactions secured by personal property as security.

12. However, in our consideration of the matter, we have adopted a pragmatic approach. While benefiting from the conceptually comprehensive scheme developed in Article 9, we have felt impelled to suggest only such changes to our personal property security law (which has no comprehensive statutory basis as yet) as may be necessary for the spread of banking and for financing creditworthy purposes, and for this purpose to have effective recourse to all available forms of personal property as security. Based on this approach, we have found that many of the provisions of Article 9 have a sound policy base and further the flow of credit for really productive purposes.

13. Under the scheme of Article 9, we have found that there are several provisions which give a favoured treatment to a creditor in the realisation of personal property as security, a preference based on the purpose for which credit has been given. However, in our country, granting of credit having regard to the purpose for which the credit is required, which is an essential function, is undertaken mainly by banks and other financing institutions which are animated by certain socio-economic objectives and which act not merely for profit but also for catalysing development. Hence, in the changes that we are suggesting we have tried to place banks and other financing institutions on a preferential position. As far as possible, for effective realisation of their rights, we have also tried to cut short the procedural steps wherever they could be avoided.

14. Another major consideration which has weighed with us is to simplify and avoid complicated legal provisions.

15. We have also been influenced by the fact that the changes that we may suggest should be acceptable to Government, banks and other financing institutions, trade and industry, and should further the development of the economy. Hence, we have restrained ourselves from suggesting extensive changes to the statutes with which the personal property security scheme may be closely related, e.g., the Motor Vehicles Act, the Registration Act, the Hire-Purchase Act, the Contract Act, etc.

The Basic Scheme

(i) *regarding registration*

16. At present, we have limitations in our country for developing a central scheme for the registration of security interests in personal property. Hence, we have not been able to suggest a central scheme of registration by bringing within one common jurisdiction the independent registration authorities which are now available for registration of secured transactions in personal property. However, we have relied on the existing provisions of the Motor Vehicles Act, the Companies Act and the Registration Act and formulated a scheme which, with some not very major changes to the existing provisions of these statutes, could immediately provide the nucleus for developing a central registration machinery and effectively serve the current requirements for perfecting a security interest in personal property.

(ii) *concept of perfection*

17. Even now, under the Companies Act, an unregistered security interest is enforceable only against the debtor-company. On registration it gets perfected and the interest becomes valid against other creditors and liquidator of the company. This concept of perfection of a security interest, by resort to appropriate steps like registration or taking possession of the security, which would give to the outside world notice of the charge, has been fully developed in other countries and forms the basis for a proper and valid classification of security interests in personal property. "Perfection", having regard to the nature of the personal property, which is by and large a movable asset, is a concept meant to notify others about the charge against the asset. As a general rule, such a perfection has to be either by registration or by possession.

(iii) *limited value of perfection by possession*

18. Personal property which is pledgeable, that is, goods, documents and instruments, may be taken possession. Against accounts receivable and other intangibles, perfection by means of possession is not available. Again, perfection by possession has got only a limited banking and commercial significance, since possession by the secured party deprives the borrower from effectively utilising his goods and merchandise which have to be constantly going through the several phases of transformation in their manufacturing and distribution processes. Hence, the importance of the registration system in the scheme of the personal property security law. Hence also the necessity to co-ordinate the registration functions of the different authorities connected with registration of security interests in personal property.

(iv) *special rules regarding perfection*

19. While by and large the general rule that perfection of a security interest has to be either by possession or by registration is valid, in its practical application this rule can be worked only subject to justifiable exceptions. For instance, as regards goods, other than motor vehicles, which are meant for the debtor's personal, family or household purposes, it is neither necessary nor feasible to insist on the registration of the security interest. In such a case, if necessary, the hire-purchase device may be adopted to secure the lender's claims where the lender has financed the acquisition of such goods. Similarly, in an import situation like the grant of credit by banks against trust receipts, perfection by possession is not feasible to facilitate this critical phase of bank lending.

(v) *classification of personal property*

20. In the scheme of personal property security law, it is necessary to have rules as to perfection and priority based on a classification of the personal property. Personal property is either tangible or intangible. Tangible assets are goods which, in turn, may be either consumer goods, inventory or other goods. Intangible assets are those that are represented by either documents of title to goods or negotiable instruments or are accounts receivable or other intangible, title to which is not embodied in any piece of paper. Article 9 scheme has made a classification for this purpose and this has also been adopted in Canada and recommended for adoption in the U.K. We have tried to reduce the classification to the minimum and in that process avoided the necessity for making fine sub-classifications of different forms of intangibles as chattel paper, as account debts, as contract rights and as other intangibles. The reduced number of classification would help people to get the import of the personal property security scheme without much difficulty.

(vi) *fusion of vendors' credit and lenders' credit*

21. One of the major reforms effected by the Article 9 scheme, which has now gained universal acceptability among experts in the field of personal property security law in all the Common Law countries, is the necessity for effecting a fusion of the schemes for the regulation of vendors' credit and lenders' credit. "Hire-purchase", as a form of security device, was developed in the U.K. to get over the difficulty that was felt, were the transaction to be described in its true character, namely, that it is to be a sale on instalment credit basis. While the development of instalment credit by way of hire-purchase has helped commercial development, the safety of the

secured party in this form of transaction has rested on the form the transaction has assumed, namely, that it is given out as a form of vendor's credit. While we may have no objection to the secured position of a person who gives such credit, the present law has not helped in a similar way, as it should the granting of credit by banks and other financing institutions of what we may term as "purchase money" In fact, this has come in the way of banks and other financing institutions not being in a position to avail themselves of the rights available to the hire-purchase lender even when they give a purchase money credit. This defect of the lending law has already been rectified in some countries and it is time it is done in our country as well. Consistent with this, in the statutory scheme which we have been asked to prepare, we have maintained the distinction between purchase money credit and non-purchase money credit. Purchase money secured creditors are entitled to a preference as, in terms of their economic function, it is justified.

(vii) *current crop loan by banks*

22. The dichotomy in agriculture of the tiller of the soil not being the owner is well known in our country, though the impetus Government is giving to land reforms is greatly reducing it. We have looked at the problem of granting credit to the tiller in his capacity as such to improve productivity in agriculture, the most important sector of our economy. Adapting the Article 9 rule in our scheme, we are providing for priority to current crop loans given by banks before the sowing season and this charge would take effect on the crops that may be grown by the agriculturist, independent of the question of ownership of the land.

(viii) *the problem of the fixture*

23. In our country, "fixture", that is, machinery or other goods which are installed in factories or other buildings, or farm equipments like motor pump-sets which may be affixed to agricultural land, is financed to a large extent by banks and other financing institutions. But the cost of creating a charge on such fixtures is unnecessarily high. This is on an assumption that they may have to be treated as immovable property and creation of a security interest in them may be considered as an interest in immovable property chargeable with duty as a land mortgage. Again, a security interest in such costly machinery, which subsequently becomes a fixture, may be impaired by being regarded as "accession" to the immovable property to which it is attached and as such available to mortgage-creditor. Conflicting judicial decisions have further complicated this question. It is necessary to frame simple rules to determine the validity and priority of security interests in fixtures, and in this process not to get involved in the subjective assessment now being made on the question, whether or not the fixture is attached for the beneficial enjoyment of the land. By and large, the machinery that becomes a fixture is attachable and removable from the immovable property. Hence, security interest in fixtures of all types should be determined on the basis that they are moveables. The rules of priority should also reconcile the conflicting claims of the mortgage-creditor and the secured party claiming against the fixture. We have adopted, in the scheme which we have suggested, the principles underlying the relevant provisions of Article 9 which has considered similar questions.

(ix) *stamp and registration charges on agreements to secure personal property*

24. In order that the procedural laws like the Stamp Act and the Registration Act are not so interpreted as to unduly inflate the cost of credit, we have suggested special provisions in the scheme to take care of such situations.

(x) *rules as to accessions*

25. On the analogy of the fixture rules, where a valuable component or machinery part is supplied on credit, the rights of the secured party financing such machinery part are stated *vis-a-vis* a person having a security interest in the machinery as a whole. In the increasing tempo of industrialisation of our country, we feel that such rules are necessary.

(xi) *coverage of the scheme* vis-a-vis *existing security devices*

26. The scheme which we have developed, based on the comparative models available to us, would envelop all forms of security agreements in personal property, whatever be their nomenclature. However, we have found it expedient to leave out of the scheme the familiar concept of floating charge over the assets of companies, and hire-purchase transaction with reference to goods, other than motor vehicles, of value not exceeding Rs. 25,000/-.

27. A secured party who claims a floating charge in preference to the security interest available under our scheme as regards the existing and future property of the debtor can still press his claim for floating charge. But it is unlikely that he would do so since the charge available to him with reference to future property under the statutory scheme we have proposed may prove to be more beneficial to him. The hire-purchase transactions of the type above referred to are not covered within our scheme as the Hire-Purchase Act can take care of such transactions and with reference to such transactions there may be need for special consideration and also need for protective provisions of the nature now found in the Hire-Purchase Act, 1972.

(xii) *exclusion of motor vehicles from the Hire-Purchase Act*

28. In the changes we have proposed to the Hire-Purchase Act we have excluded from its scope hire-purchase of motor vehicles which is probably one of the most popular forms of hire-purchase finance. However, it will be more appropriate to deal with the security interests over motor vehicles under the personal property security law than to regulate them as a form of hire-purchase finance. In this process, it is true, hirers of motor vehicles may not get the protection now proposed to be extended to them under the Hire-Purchase Act, 1972. However, the Act has not yet been brought into force. Having regard to the value of motor vehicles and the class of persons who will form the class of hirers, it is unlikely that they will be put to any prejudice by reason of the inapplicability of the Act to them. On the other hand, hire-purchase lenders over motor vehicles, and banks and other financing institutions giving credit on hypothecation against motor vehicles would be treated on par under our scheme, whereby both would be eligible to claim purchase money security interest. This would facilitate the flow of necessary credit to transport industry and at the same time help to reduce the cost of the credit. The amendments we have proposed to the Motor Vehicles Act and the provisions we have suggested in the statutory scheme are also designed to reduce the scope for fraudulent actions to defeat the claims of secured parties.

(xiii) *how existing security devices would be looked upon under the new scheme*

29. The statutory scheme we have suggested will not be detrimental to the interest of those who may continue to use the existing forms of security agreements like hypothecation, pledge, trust receipts, etc. But such transactions would be viewed under the scheme having regard to the purpose of

the finance, whether the security is held by the secured party or by the debtor, the perfected or unperfected nature of the transaction, and the nature of the property taken as security. Article 9 scheme lays down clear rules to determine the rights of parties based on such an assessment and we have adopted, and in that process tried to simplify, that scheme to suit our requirements.

(xiv) *banks' hypothecation advances to non-corporate debtors*

30. As earlier stated, our scheme recognises the special position of banks and other financing institutions in the field of secured transactions. In this process we have tried to rectify certain difficulties faced by banks with reference to their hypothecation advances to non-corporate borrowers. In such cases, in practical terms, such advances are at present assessed mainly as unsecured advances. This position will cease to be valid under our scheme. An unperfected security interest of a bank in the inventory of a non-corporate debtor gives the bank, under our scheme, as effective a security as the bank would have with reference to a similar charge on the assets of a corporate debtor.

31. On the other hand, we are aware that financing against the inventory of a non-corporate debtor by persons other than banks or other financing institutions is not usual. In such a situation, it is necessary to preserve, and our scheme takes care of, the claims of the general body of creditors against the non-corporate debtor.

(xv) *unperfected security interest of banks*

32. While going into the rights and remedies of a secured party on the default of the debtor, we have continued to maintain the distinction between a bank-lender and others. The rights and remedies available to the perfected security interest holders are available to banks whether or not their security interest is perfected. Under our scheme, the secured party has rights to take possession of the security appoint a receiver, make direct collections, and to dispose of the security in a reasonable manner. These rights are not proposed to be extended to unperfected security interest holders who are not banks.

(xvi) *further observations*

33. There has to be a continuing co-ordination of the registration scheme now available and it is also necessary to maintain a continuous review of the working of the scheme having regard to the objective underlying the same. For this purpose, we have proposed that the Central Government should be empowered to frame rules for the effective implementation of the Act.

34. We also hope that the Reserve Bank of India, as the central banking authority, will also take interest in the working of the scheme of the personal property security law, and that the Reserve Bank and the Government together will explore the feasibility of setting up, in not a very distant future, a centralised machinery with appropriate set-up at the unit level to serve as a data bank on secured transactions and providing for registration. On the development of such a central machinery, with appropriate strength at the unit and regional levels, the statutory scheme which we are now proposing would require to be further reviewed. While the scheme is meant for immediate implementation, the advantages of taking steps from now on

for developing a central registration machinery with sufficient strength at all levels need no over-emphasis. It may be necessary to computerise the system. Though the financial implications may have to be carefully studied, in the long run the set-up may prove to be a paying proposition, helping to expedite the tempo of commercial and industrial transactions and consequently the economic development of our country.

35. A statutory scheme of the type we have here proposed is based on certain underlying policy objectives and an analysis of the economic function of different classes of credit-purveyors. Hence, it is necessary to keep a continuous watch even after legislation. Such a continuous review has been found necessary and beneficial in the working of the Article 9 scheme in the U.S.A. We do hope that the Central Government and the Reserve Bank of India would go into this aspect and take necessary steps.

36. We have not attempted to go into the details of our scheme since the provisions we have suggested speak for themselves. We have incorporated our suggestions in the form of a draft Bill in order to facilitate consideration. The text of the model for legislation, proposed by us, to reform and clarify the law regarding the obtaining of personal property as security is given in the following pages.

Acknowledgements

37. We are grateful to the Banking Laws Committee and its Chairman for giving us the opportunity to participate in the process of reform of this vital area of credit-security law. We are also thankful to him for generously making available to us the valuable materials and data which the Committee has gathered. The Chairman of the Banking Laws Committee has also helped us greatly by giving his valuable guidance during the meetings the members of the Project Team have had with him.

38. We are also grateful to the Hon'ble Deputy Minister of Finance, Shrimati Susheela Rohatgi, for sparing time and for giving the benefit of her guidance on the matters pertaining to our Project.

39. We acknowledge the guidance we had from comparable legislation in the U.S.A. and Canada, and from the writings of experts, a few of whom we have referred to earlier.

40. We also thank the officers of the Banking Laws Committee, particularly, Shri S. B. Fos, Banking Officer, Shri N. K. Puri, Legal Officer, and Shri O. S. Khanna, Staff Officer, who attended many of our meetings and made useful contribution to our discussions. Shri V. Vembu, Personal Assistant, has done with cheer a painstaking job and has done it with commendable efficiency.

Sd/-
(DR. K. B. ROHATGI)

Sd/-
(R. KRISHNAN)

Sd/-
(DR. K. PONNUSWAMY)

Sd/-
(DR. B. SIVARAMAYYA)

DELHI,
31*st May*, 1976.

THE PERSONAL PROPERTY SECURITY ACT, 197—

(——— of 197—)

An Act to reform and clarify the law regarding security interests in goods, fixtures, documents of title, instruments, actionable claims and other general intangibles.

BE it enacted by Parliament in the ——————— year of the Republic of India as follows :—

CHAPTER I

PRELIMINARY

1. *Short title, commencement and extent.*—(i) This Act may be called the Personal Property Security Act, 197—.

(ii) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint, and different dates may be specified for bringing into force the different provisions of this Act.

(iii) It extends to the whole of India except the State of Jammu and Kashmir.

2. *Definitions.*—In this Act, unless the context otherwise requires,—

(i) "accessions" means goods that are installed in or affixed to any other goods ;

(ii) "bank" means a banking company as defined in the Banking Regulation Act, 1949, or any other financial institution which the Central Government may notify in this behalf ;

(iii) "building" includes a structure, erection, mine or work built, erected or constructed on or in land ;

(iv) "building materials" includes goods that are or become so incorporated or built into a building that their removal therefrom would necessarily involve the removal or destruction of some other part of the building and thereby cause substantial damage to the building apart from the value of the goods removed, but does not include goods that are severable from the building or land merely by unscrewing, unbelting, unclamping or uncoupling or by some other method of disconnection, and does not also include machinery installed in a building for use in the carrying on of an activity where the only substantial damage, apart from the value of the machinery removed, that would necessarily be caused to the building in removing the machinery therefrom is that arising from the removal or destruction of the bed of casing on or in which the machinery is set and the making or enlargement of an opening in the walls of the building sufficient for the removal of the machinery ;

(v) "company" means a company as defined in the Companies Act, 1956.

(vi) "consumer goods" means goods, other than motor vehicles, that are used or acquired by a debtor for his personal, family or household purposes ;

(vii) "court" means the Court having jurisdiction under section 10 of the Companies Act, 1956, where the debtor is a company, and the Civil Court of competent jurisdiction in other cases ;

(viii) "creditor" includes an assignee for the benefit of creditors, a legal representative, assignee or official receiver under insolvency, a liquidator, a receiver, an executor or an administrator ;

(ix) "debtor" means a person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the property, and includes an assignor of a general intangible ; and where the debtor and the owner of the property are not the same person, the term "debtor" means the owner of the property in any provision of this Act dealing with the property, the obliger in any provision dealing with the obligation, and may include both when the context so requires ;

(x) "default" means the failure to pay or otherwise perform the obligation secured when due or the occurrence of any event whereupon under the terms of the security agreement the security becomes enforceable ;

(xi) "document of title" means any writing which purports to be issued by or addressed to a bailee and purports to cover such goods in the bailee's possession as are identified or fungible portions of an identified mass, and which in the ordinary course of business is treated as establishing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers ;

(xii) "fixture" means goods embedded in the earth, or affixed to what are so embedded, but does not include building or building materials ;

(xiii) "fungible" with respect to goods means goods of which any unit is, by nature or usage of trade, the equivalent of any other like unit ;

(xiv) "future property" means personal property to be manufactured, produced or acquired by the debtor after the making of the security agreement ;

(xv) "general intangible" means personal property including actionable claims or other intangibles, but excluding goods, documents of title and instruments ;

(xvi) "goods" means all movable properties including fixtures, growing crops, grass and standing timber, but does not include instruments, documents of title and general intangibles ;

(xvii) "instrument" means a bill of exchange or a promissory note or a cheque within the meaning of the Negotiable Instruments Act, 1881, an indigenous negotiable instrument (hundi), and share, stock, warrant, bond, debenture or the like or any other writing that evidences a right to the payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, but does not include a document of title ;

(xviii) "inventory" means goods —

(a) that are held by a person for sale or lease; or

(b) that are raw materials, goods in process or goods consumed in any industry, business or profession ;

(xix) "motor vehicle" means a motor vehicle as defined in the Motor Vehicles Act, 1939 ;

(xx) "negotiable document of title" means a document of title, title to which is transferable by mere delivery or by mere endorement and delivery, as the case may be ;

(xxi) "negotiable instrument" means a bill of exchange or a promissory note or a cheque governed by the Negotiable Instruments Act, 1881, or an indigenous negotiable instrument (hundi), a share, warrant, or any other instrument, title to which is transferable by mere delivery or by mere endorsement and delivery, as the case may be;

(xxii) "personal property" means, goods, fixture, document of title, instrument or general intangibles;

(xxiii) "prescribed" means prescribed by rules framed under this Act;

(xxiv) "proceeds" means personal property in any form or money received or obtained on the collection or disposition of the property or on the disposition of personal property so received or obtained. "Proceeds" also includes payment representing indemnity or compensation for loss or damage to such property, except to the extent that it is payable to a person other than a party to the security agreement;

(xxv) "the property" means any personal property that is subject to the security interest covered by a security agreement;

(xxvi) "purchase" includes taking by sale, lease, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in the property;

(xxvii) "purchaser" means a person who takes by purchase;

(xxviii) the expressions "registered", "registration", "registration of security agreement" and "registration of security interest" shall mean registration of the security interest in the property in accordance with Chapter VII of this Act;

(xxix) "rules" means rules framed under this Act;

(xxx) "secured party" means a lender, seller or any other person in whose favour there is a security interest, including a person to whom general intangibles have been assigned or sold;

(xxxi) "security agreement" means an agreement that creates or provides for a security interest;

(xxxii) "security interest" means an interest in personal property which secures payment or performance of an engagement which may give rise to a pecuniary liability, and includes an interest arising from an assignment or sale of general intangibles whether or not intended as security;

(xxxiii) "security interest for purchase money" means a security interest that is—

(a) taken or reserved by the seller of the property to secure payment in whole or in part of its price; or

(b) taken by a person who gives value for the purpose of enabling the debtor to acquire rights in the property, if such value is applied to acquire such rights;

(xxxiv) "value" means any consideration sufficient to support a contract, and includes an antecedent debt or liability.

CHAPTER II

General Applicability

3. *Application of Act.*—Subject to the provisions of section 4, this Act applies—

(a) to every security agreement that in substance creates a security interest in personal property, without regard to its form and without regard to the person who has title to the property, including, but without limiting the foregoing, any pledge, mortgage, hypothecation, floating charge, trust receipt, conditional sale or hire-purchase, and any lease intended as security; and

(b) to every assignment of general intangibles whether or not intended as security but not to an assignment for the general benefit of creditors.

4. *Where Act does not apply.*—This Act does not apply—

(a) to a lien given by statute, except as regards the lien for materials furnished or services rendered as provided under section 46;

(b) to a banker's lien, a landlord's lien or any right of set-off;

(c) to the creation of a security interest in aircraft, and in vessels as defined in the Merchant Shipping Act, 1959;

(d) to a transaction governed by any Pawnbrokers Act or by the Hire-Purchase Act, 1972.

5. *Moneylending legislation not affected.*—Nothing in this Act shall affect the operation of any provisions relating to moneylenders and moneylending legislation.

6. *Description of the property.*—For the purposes of this Act, any description of the property or of any immovable property to which the property is embedded or affixed is sufficient whether or not the description is specific, if it reasonably identifies what is described.

CHAPTER III

General effect of security agreement

7. *Effectiveness of security agreement.*—Except as otherwise provided by this or any other Act, a security agreement is effective according to its terms between the parties, and likewise against the purchasers of the property and against creditors.

8. *When security interest attaches.*—A security interest attaches to the property when—

(a) the parties intend it to attach;

(b) value is given; and

(c) the debtor has rights in the property.

9. *Enforceability of security interest.*—Subject to the other provisions of this Act, a security interest which has attached is enforceable with respect to the property against the debtor or third parties only when the property is in the possession of the secured party by reason of agreement, or the debtor has signed the security agreement which contains a description of the property and, in addition, when the security interest covers crops growing or to be grown or grass or timber to be cut, or fixtures, a description of the land concerned.

10. *Future property.*—(1) Except as provided in sub-section (2), a security agreement may cover future property.

(2) No security interest attaches to consumer goods, other than accessions, under a future property clause in a security agreement, unless the debtor acquires rights in them within ten days after the secured party gives value.

11. *Future property as security for antecedent debt.*—Where a secured party makes an advance, incurs an obligation, releases a perfected security interest or otherwise gives new value which is to be secured in whole or in part by future property, his security interest in the future property shall be deemed to be taken for new value and not as security for antecedent debt if the debtor acquires his rights in the property either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

12. *Future advances.*—A security agreement may secure future advances, the performance of an engagement or the balance of a running account if it expresses the maximum to be secured thereby, and a subsequent security agreement over the same property shall, when made with notice of the prior security interest, be postponed to the prior security interest in respect of advances or debits not exceeding the maximum, though made or allowed with notice of the subsequent security interest.

13. *Effect of debtor's right of disposition.*—A security interest is not invalid or fraudulent against other creditors merely by reason of liberty in the debtor to use, commingle or dispose of all or part of the property (including returned or re-possessed goods), or to collect from or compromise with debtors on general intangibles, or to accept the return of goods or make re-possessions, or to use commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace the property. This section does not relax the requirement as to possession where perfection of a security interest depends upon possession of the property by the secured party or by a bailee.

14. *Security interest as security.*—A secured party may by entering into a security agreement create a security interest upon his security interest in the property on terms that do not impair his debtor's right to redeem the property.

15. *Agreement not to assert defence against assignee.*—Notwithstanding anything contained in any other law, an agreement by a debtor not to assert against an assignee any claim or defence that he has against his seller or lessor is enforceable by the assignee who takes the assignment for value, in good faith and without notice of such claim or defence.

Exception (1).—This section shall not apply to consumer goods.

Exception (2).—This section shall not apply to defences which may be asserted against the holder in due course of a negotiable instrument under the Negotiable Instruments Act, 1881.

16. *Seller's warranties.*—Where a seller retains a security interest for purchase money in goods,—

(a) the Sale of Goods Act, 1930, governs the contract of sale of goods and any exclusion, waiver, limitation or modification of the seller's conditions and warranties; and

(b) except as provided in section 15, the conditions and warranties in the contract of sale of goods shall not be affected by any security agreement.

17. *Care of the property.*—(1) A secured party shall take such care in the custody and preservation of the property in his possession as is required of a bailee under sections 151 and 152 of the Indian Contract Act, 1872, and, unless otherwise agreed, in the case of an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties.

(2) Unless otherwise agreed, where the property is in a secured party's possession,—

(a) all necessary expenses incurred by him in respect of the possession or for the preservation of the property, including the cost of insurance and payment of taxes or other charges, are chargeable to the debtor and are secured by the property;

(b) the risk of loss or damage, except where caused by the negligence of the secured party, is on the debtor;

(c) the secured party may also additionally hold as the property any increase or profit, except money, received from the property, and money so received, unless remitted to the debtor, shall be applied forthwith upon its receipt in reduction of the secured obligation; and

(d) the secured party shall keep the property identifiable, but fungibles may be commingled.

(3) A secured party may use or operate the property for the purpose of preserving the property or its value or pursuant to the order of the Court or in the manner and extent provided for in the security agreement.

(4) A secured party is liable for any loss or damage caused by his failure to meet any of the obligations imposed by this section, but does not lose his security interest.

18. *Alienation of rights of debtor.*—The rights of a debtor in the property may be transferred voluntarily or involuntarily notwithstanding a provision in the security agreement prohibiting transfer or declaring a transfer to be a

default, but no transfer prejudices the rights of the secured party under the security agreement or otherwise, including the right to treat a transfer prohibited by the security agreement as an act of default.

19. *Determination of stamp duty on security agreement.*—Notwithstanding anything contained in the Stamp Act, 1899, any security agreement purporting to create a security interest in any form of personal property shall be liable to stamp duty under that Act, only as an agreement.

20. *Charges for registration under Registration Act.*—Registration of any security interest in fixture or other personal property under Part III-A of the Registration Act, 1908, shall be effected on the payment of charges payable for the registration of an agreement relating to a movable property which is optionally registrable.

CHAPTER IV

PERFECTION

21. *Security interest when perfected.*—(1) A security interest which has attached is perfected when all steps required for perfection under this Act have been taken, regardless of the order in which the steps have been taken.

(2) Where the steps for perfection have been taken before the security interest attaches, the security interest is perfected when it attaches.

22. *Continuity of perfection.*—(1) If a security interest is originally perfected in any way permitted under this Act and is again perfected in some other way under this Act without an intermediate period when it was unperfected, the security interest shall be deemed to be perfected continuously for the purposes of this Act.

(2) *Assignee.*—An assignee of security interest succeeds, in so far as its perfection is concerned, to the position of the assignor at the time of the assignment.

23. *Perfection by possession.*—Except as provided in section 26, possession of the property by the secured party, or on his behalf by a person other than the debtor or the debtor's agent, perfects a security interest in—

(a) goods,

(b) instrument, or

(c) negotiable document of title,

but, subject to section 22, only so long as the secured party continues to be in possession of the property as such:

Provided that with reference to an instrument or a negotiable document of title, the requirements of any other applicable law relating to transfer or assignment of such an instrument or document of title shall also be complied with before a secured party can seek to enforce his perfected security interest in the instrument or negotiable document of title.

24. *Perfection by registration.*—Subject to section 21, registration perfects a security interest in—

(a) goods;

(b) general intangible ; or

(c) any type of future property.

25. *Security interest for purchase money in consumer goods.*—A security interest for purchase money in consumer goods which has attached becomes perfected on attachment. However, where such goods are intended to become, or have become, a fixture, registration of such security interest as applicable to a fixture is necessary to claim priority as a perfected security interest over a conflicting security interest in the fixture.

26. *Temporary perfection by banks.*—(1) When the secured party is a bank, a security interest in an instrument or a negotiable document of title is deemed to be perfected without the taking of possession for a period of thirty days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(2) A perfected security interest in—

(a) an instrument which a secured party delivers to the debtor for the purpose of—

(i) ultimate sale or exchange, or

(ii) presentation, collection or renewal, or

(iii) registration of transfer; or

(b) a negotiable document of title or goods held by a bailee that are not covered by a negotiable document of title, which document of title or goods the secured party makes available to the debtor for the purpose of—

(i) ultimate sale or exchange, or

(ii) loading, unloading, storing, shipping, or transhipping, or

(iii) manufacturing, processing, packaging or otherwise dealing with the goods in a manner preliminary to their sale or exchange;

remains perfected for a period of thirty days after the property comes under the control of the debtor, but priority between conflicting security interests in the goods is subject to section 37.

(3) After the thirty day period referred to in sub-sections (1) and (2), perfection depends upon compliance with the applicable provisions of this Act.

27. *Perfecting as to proceeds.*—(1) Except where this Act otherwise provides, a security interest continues in the property notwithstanding the sale, exchange or other disposition thereof, unless the disposition was authorised by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

(2) A security interest in proceeds remains perfected if the interest in the original property was perfected, but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless—

(a) the security interest is a registered one and the security agreement relating thereto covers the original property and the proceeds therefrom; or

(b) the security interest in the proceeds is otherwise perfected before the expiration of the ten day period;

but there is no perfected security interest in proceeds that are not identifiable or traceable

28. *Perfecting as to goods held by bailee.*—(1) A security interest in goods in the possession of a bailee who has issued, or to whom is addressed, a negotiable document of title covering them is perfected by perfecting a security interest in the document, and any security interest in them otherwise perfected while they are so covered is subject thereto.

(2) A security interest in goods in the possession of a bailee, other than the one who has issued a negotiable document of title therefor is perfected—

(a) by the bailee issuing a document of title in the name of the secured party; or

(b) by the bailee agreeing to hold the goods on behalf of the secured party.

29. *Goods returned or re-possessed.*—(1) A security interest in goods that are the subject of a sale, lease or exchange and that are returned to, or repossessed by,—

(a) the person who sold, leased or exchanged them; or

(b) a transferee of a general intangible resulting from the sale or lease of them,

re-attaches to the extent that the secured indebtedness remains unpaid.

(2) Where the security interest was perfected by registration that is still effective at the time of the sale, lease or exchange, it re-attaches as a perfected security interest, but in any other case it requires fresh steps for its perfection.

(3) A transferee of a general intangible resulting from a sale or lease has a security interest in the returned or re-possessed goods as against the transferor. Against creditors of the transferor and purchasers of the returned or re-possessed goods, the security interest of such a transferee who is unpaid will remain unperfected unless with reference to such goods the transferee perfects his security interest.

CHAPTER V

EFFECT OF PERFECTION AND RULES OF PRIORITY

30. *Priorities—General rule.*—(1) Subject to the other provisions of this Act, priority between security interests in the same property shall be determined—

(a) by the order of registration, if the security interests have been perfected by registration;

(b) by the order of perfection, unless the security interests have been perfected by registration; or

(c) by the order in which the security interests have attached, if no security interest has been perfected.

(2) For the purposes of sub-section (1), a continuously perfected security interest shall be treated at all times as if perfected by registration if it was originally so perfected, and it shall be treated at all times as if perfected otherwise than by registration if it was originally perfected otherwise than by registration.

31. *Subordination of unperfected security interest.*—Subject to sub-section (2) of section 32, an unperfected security interest is subordinate to the interest of a person who is entitled to a priority under this or any other Act.

32. *Unperfected security interest.*—(1) The claims of a secured party who is not a bank and who has an unperfected security interest in the property is subordinate to—

(i) the claims of a subsequent purchaser of the property, where the purchase was in the ordinary course of business of the debtor and in other cases the purchase was in good faith for value without knowledge of the unperfected security interest;

(ii) the claims of an unsecured creditor of the debtor who, whether before or after the creation of an unperfected security interest, acquires through judicial process a lien on the property by attachment or the like; and

(iii) the claims of the official assignee, receiver or liquidator acting under the insolvency law.

(2) *Preference to banks.*—Where the debtor is not a company and the property is not a motor vehicle or a fixture, the claim of a secured party who is a bank and who has attached in its favour an unperfected security interest in the property ranks in preference to the claims of the persons referred to in clauses (i), (ii) and (iii) of sub-section (1).

33. *Priority subject to subordination.*—A secured party may, in the security agreement or otherwise, subordinate his security interest to any other security interest.

34. *Effect of registration of security interest in motor vehicles.*—Where a secured party enters into a security agreement with a debtor, regarding the property which is a motor vehicle in good faith and for consideration, in whose name the Certificate of Registration of the motor vehicle stands, and the security agreement is registered under section 31A of the Motor Vehicles Act, 1939, any other person claiming an interest in the vehicle as owner, or joint-owner, shall be precluded from asserting his claim in preference to the claims of such secured party.

A. EFFECT OF PERFECTION ON PURCHASERS

35. *Effect of perfection on buyer of goods in ordinary course of business.*—(1) A buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free from any perfected or unperfected security interest therein given by the seller or lessor whether or not the buyer or lessee knows of it unless he also actually knows that the sale or lease constitutes a breach of the security agreement.

(2) For the purposes of sub-section (1), the sale may be for cash or on credit and includes delivering goods or a document of title under a preexisting contract of sale but does not include a transfer as security for or in total or partial satisfaction of a money debt.

36. *Bona fide purchaser of negotiable instrument and document.*—Nothing in this Act limits the rights of a bona fide purchaser or a holder in due course of a negotiable instrument or the rights of a holder to whom a negotiable document of title has been duly negotiated and such purchaser or holder takes priority over an earlier security interest even though perfected.

37. *Transferee of general intangible.*—The security interest of a transferee of a general intangible resulting from a sale or lease is subordinated to a security interest under sub-section (1) of section 29 that was a perfected security interest when the goods became the subject of the sale, lease or exchange.

B. PRIORITY FOR SECURITY INTEREST FOR PURCHASE MONEY

38. *Security interest for purchase money.*—A security interest for purchase money that is perfected before or within ten days after the debtor's possession of the property commences has priority over the interest of a transferee under a transfer not in the ordinary course of business of the transferor occurring between attachment and perfection of the security interest.

39. *Security interest for purchase money in inventory.*—A perfected security interest for purchase money in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if—

(a) the security interest for purchase money is perfected at the time the debtor receives possession of the inventory; and

(b) the party having a security interest for purchase money gives notice in writing to the holder of the conflicting security interest if the holder had registered his security interest covering the same types of inventory (i) before the date of the registration by such party, or (ii) before the beginning of the thirty day period where the security interest for purchase money is temporarily perfected under sub-section (2) of section 26; and

(c) the holder of the conflicting security interest receives the notice before the debtor receives possession of the inventory; and

(d) the notice states that the person giving the notice has or expects to acquire a security interest for purchase money in the inventory of the debtor, describing such inventory by item or type.

40. *Security interest for purchase money in other assets.*—A security interest for purchase money in the property or its proceeds, other than inventory, has priority over any other security interest in the same property if the security interest for purchase money was perfected at the time the debtor obtained possession of the property or within ten days thereafter.

C. CURRENT CROP LOANS BY BANKS

41. *Current crop loans by banks.*—Where a bank obtains a perfected security interest in crops or their proceeds given for a consideration to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise has priority over any earlier perfected security interest, even though the person giving the consideration knew of the earlier security interest:

Provided that the period of three months specified above may be varied for different areas of the country having regard to local conditions, and this may again be varied from time to time, by rules made in this behalf.

D. RULES AS TO FIXTURES

42. *Priority of security interest in fixtures.*—(1) Subject to sub-section (3) and notwithstanding section 40, a security interest that attached to goods before they became fixtures has priority as to the goods over the claim of any person who has an interest in the immovable property.

(2) Subject to sub-section (3), a perfected security interest in a fixture has priority over the claim of any person who subsequently acquired an interest in the immovable property, but not over any person who had a registered interest in the immovable property at the time the security interest attached to the goods.

(3) The security interest in a fixture referred to in sub-sections (1) and (2) is subordinate to the security interest of—

(a) a subsequent purchaser for value of an interest in the immovable property, or

(b) a creditor with a prior registered encumbrance on the immovable property in respect of any subsequent advance made in accordance with section 79 of the Transfer of Property Act, 1882,

if the subsequent purchase is made or the subsequent advance under which the prior encumbrance is made is contracted for, as the case may be, in good faith and without notice of the security interest and before it is perfected.

E. RULES AS TO ACCESSIONS

43. *Accessions.*—(1) Subject to sub-section (2) and to section 45 and notwithstanding section 40,

(a) a security interest in goods which become accessions after that security interest is attached takes priority as to the accessions over the claim of any person in respect of the whole; and

(b) a security interest in goods that attached after the goods became accessions has priority over the claim of any person who subsequently acquired an interest in the whole, but not against a person who had an interest in the whole at the date of attachment of the security interest in the accessions.

(2) A security interest referred to in sub-section (1) is subordinate to the interest of—

(a) a subsequent purchaser for value of an interest in the whole, or

(b) a creditor with a prior perfected security interest in the whole to the extent that he makes any subsequent advance in accordance with section 12,

if the subsequent purchase was made or the subsequent advance under the prior perfected security interest was made or contracted for without knowledge of the security interest and before it is perfected.

F. ASSIGNEES OF GENERAL INTANGIBLES

44. *Assignee of a general intangible.*—(1) Unless a debtor on a general intangible has made an enforceable agreement not to assert defences or claims arising out of a contract, the rights of an assignee are subject to—

(a) all the terms of the contract between the debtor on a general intangible and the assignor and any defence or claim arising therefrom; and

(b) any other defence or claim of the debtor on a general intangible against the assignor that accrued before the debtor on a general intangible received notice of the assignment.

(2) So far as the right to payment under an assigned contract has not been earned by performance, and nothwithstanding notice of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards and without material adverse effect upon the assignee's rights under or the assignor's ability to perform the contract is effective against an assignee unless the debtor on a general intangible has otherwise agreed but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.

(3) The debtor on a general intangible may pay the assignor until the debtor on a general intangible receives notice from the assignee, a reasonably identifying the relevant rights, that the debt has been assigned, and, if requested by the debtor on a general intangible, the assignee shall furnish proof within a reasonable time that the assignment has been made, and, if he does not do so, the debtor on a general intangible may pay the assignor.

(4) A term in any contract between a debtor on a general intangible and an assignor which prohibits assignment of the whole of a debt is ineffective.

G. COMMINGLED GOODS

45. *Commingled goods.*—A perfected security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass, and, if more than one security interest attaches to the product or mass, the security interests rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

H. MATERIAL AND SERVICES LIEN

46. *Priority of lien for materials and services.*—(1) Where a person in the ordinary course of business furnishes materials or renders services involving the exercise of labour or skill in respect of the goods that are subject to a security interest, he has, in the absence of a contract to the contrary, priority over a perfected security interest and a right to retain such goods until he receives the payment for the materials furnished or remuneration for the services rendered.

(2) *Priority of non-possessory liens.*—Where a person in the ordinary course of business furnishes materials or renders services with respect to goods not in his possession that are subject to a security interest, any lien that he has under any Act in respect of the materials or services has such priority over a perfected security interest as is given by that Act.

CHAPTER VI

RIGHTS AND REMEDIES ON DEFAULT

47. *Banks and perfected security interest holders.*—(1) The rights and remedies under sections 48 to 55 are available to all perfected security interest holders and to unperfected security interest holders who are banks.

(2) *Unperfected security interest holders.*—An unperfected security interest holder who is not a bank may proceed against the property only through Court notwithstanding anything contained in the security agreement.

48. *Secured party's right to take possession upon default.*—Upon default under a security agreement—

(a) the secured party has the right to take possession of the property. In taking possession, the secured party may proceed without judicial process if this can be done without breach of peace or he may proceed through Court. If the security agreement so provides, the secured party may require the debtor to assemble the property and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both the parties; or

(b) if the security interest has been perfected by registration, the secured party may, in a reasonable manner, render the goods other than consumer goods or inventory temporarily unusable without removal thereof from the debtor's premises.

49. *Removal of accession.*—(1) Unless otherwise agreed, if a secured party, by virtue of sub-sections (1) and (2) of section 43, has priority over the claim of any person having a security interest in the whole, he may, on default, subject to the provisions of this Act respecting default, remove the property from the whole if he reimburses any encumbrancer or owner of the whole who is not the debtor for the cost of repairing any structural damage excluding diminution in value of the whole caused by the absence of the goods removed or by the necessity for replacement, but a person so entitled to reimbursement may refuse permission to so remove until the secured party has given adequate security for any reimbursement arising under this sub-section.

(2) A person having a security interest in the whole that is subordinate to a security interest by virtue of sub-sections (1) and (2) of section 43 may, before the property has been removed by the secured party in accordance with sub-section (1), redeem the property upon payment to the secured party of the amount owing under the security interest having priority over his claim.

50. *Removal of fixtures.*—(1) Unless otherwise agreed, if a secured party, by virtue of sub-section (1) or (2) and sub-section (3) of section 42, has priority over the claim of a person having an interest in the immovable property, he may on default, subject to the provisions of this Act respecting default, remove the fixture from the immovable property if he reimburses any encumbrancer or owner of the immovable property who is not the debtor for the cost of repairing any structural damage excluding diminution in the value of the immovable property caused by the absence of the goods removed or by the necessity for replacement, but a person so entitled to reimbursement may refuse permission to remove until the secured party has given adequate security for any reimbursement arising under this sub-section :

Provided the secured party shall not be entitled to remove the fixture from the premises to which it is affixed unless he has given to each person in whose favour exists a registered security interest in the land a notice in writing of his intention to remove the fixture and unless each such person fails to pay the amount due and payable on the fixture within a period of twentyone days after the giving of the notice to him or within such longer period as the Court may grant.

(2) *Retention of the property.*—A person having an interest in the immovable property that is subordinate to a security interest by virtue of sub-section (1) or (2) and sub-section (3) of section 42, may, before the property has been removed from the immovable property by the secured party in accordance with sub-section (1), retain the property upon payment to the secured party of the amount owing under the security interest having priority over his claim.

51. *Appointment of receiver.*—The parties to a security agreement may agree that the secured party may appoint a receiver. On such appointment, the receiver shall have *mutatis mutandis* the same powers and responsibilities as are conferred on a receiver appointed under section 69A of the Transfer of Property Act, 1882.

52. *Secured party's rights over general intangibles.*—(1) Where so agreed under a security agreement and in any event upon default, a secured party is entitled—

(a) to require the obligor on a general intangible to make payment to him by giving the obligor a notice in writing whether or not the assignor was theretofore making collections on the property; or

(b) to take over any proceeds to which he is entitled under section 27.

(2) *Secured party's rights over instruments,*—Where so agreed under a security agreement and in any event upon default a secured party is entitled to take steps to collect the amount due under an instrument that may have been assigned to him, and to take over any proceeds to which he is entitled under section 27, but, the obligor on the instrument may recognise the secured party's claims in such instrument only subject to the provisions of any applicable law governing the assignment and payment on the instrument.

(3) A secured party who by agreement is entitled to charge back uncollected property or otherwise to full or limited recourse against the debtor and who undertakes to collect from the obligor on a general intangible or instrument shall proceed in a commercially reasonable manner and may deduct his reasonable expenses of realisation from the collections.

53. *Secured party's right to dispose of the property upon default.*—(1) Upon default under a security agreement, the secured party may dispose of any of the property in its then condition or after any commercially reasonable repairing, processing or preparation for disposition, and the proceeds of the disposition shall be applied in the following order :

(a) the reasonable expenses of holding, repairing, processing, preparing for disposition and disposing of the property and, to the extent provided for in the security agreement and not prohibited by law, any other reasonable expenses incurred by the secured party;

(b) the satisfaction of the obligation secured by the security interest of the party making the disposition; and

(c) the satisfaction of the obligation secured by any subordinate security interest in the property, if written demand therefor is received by the party making the disposition before the distribution of the proceeds is completed :

Provided that before satisfying the obligation of the subordinate security interest holder, the secured party shall give notice of such written demand to the debtor and if the debtor expresses his objection to such satisfaction within twentyone days from the date of receipt of the notice, the secured party shall deposit the surplus proceeds in Court.

(2) *Proof of subordinate security interest.*—Where a written demand under clause (c) of sub-section (1) is received by the secured party, he may request the holder of the subordinate security interest to furnish him with reasonable proof of such holder's interest, and, unless such holder furnishes such proof within a reasonable time, the demand of the subordinate security interest holder shall fail.

(3) *Methods of disposition.*—The property may be disposed of in whole or in part, and any such disposition may be by public sale, private sale, lease or otherwise and, subject to sub-section (6), may be made at any time and place and on any terms so long as every aspect of the disposition is commercially reasonable.

(4) *Bank may dispose of property without possession.*—Where the secured party is a bank, he may dispose of the property on the debtor's premises without taking possession thereof.

(5) *Secured party to dispose in reasonable time.*—The secured party may retain the property in whole or in part for such period of time as is commercially reasonable.

(6) *Notice of disposition.*—Unless the property is perishable or unless the secured party believes on reasonable grounds that the property will decline speedily in value, the secured party shall give to the debtor and to any other person who has a security interest in the property and who either has registered his security interest or is known by the secured party to have a security interest in the property, not less than fifteen days' notice in writing of his intention to dispose of the property. The notice shall contain :

(a) a brief description of the property;

(b) the amount required to satisfy the obligation secured by his security interest;

(c) the sums actually in arrear, exclusive of the operation of any acceleration clause in the security agreement, or a brief description of any other provisions of the security agreement for the breach of which the secured party intends to dispose of the property;

(d) the amount of the applicable expenses referred to in clause (a) of sub-section (1) or, in a case where the amount of such expenses has not been determined, his reasonable estimate thereof;

(e) a statement that upon payment of the amounts due under clauses (b) and (d) above the debtor may redeem the property;

(f) a statement that upon payment of the sums actually in arrear or the curing of any other default, as the case may be, together with the amounts due under clause (a) of sub-section (1) the debtor may reinstate the security agreement;

(g) a statement that unless the property is redeemed or the security agreement is reinstated the property will be disposed of and the debtor may be liable for any deficiency; and

(h) the date, time and place of any public sale or of the date after which any private disposition of the property is to be made.

(7) *Service of notice.*—The notice required by sub-section (6) shall be sent by registered post acknowledgement due to the latest known postal address.

(8) *Secured party's right to purchase the property.*—The secured party may, with the permission of the Court, purchase the property or any part thereof at a public sale.

(9) *Effect of disposition of the property.*—Where the property is disposed of in accordance with this section, the disposition discharges the security interest of the secured party making the disposition and, if such disposition is made to a *bona fide* purchaser for value, discharges also any subordinate security interest and terminates the debtor's interest in the property.

(10) *Purchaser's rights.*—The purchaser takes free of all such rights and interests even though the secured party fails to comply with the requirements of this Chapter or of any judicial proceedings—

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

(11) *Certain transfers of the property.*—A person who is liable to a secured party under a guarantee, endorsement, covenant, repurchase agreement or the like and who receives a transfer of the property from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party, and such a transfer of the property is not a disposition of the property.

(12) *Regarding Court Receiver.*—Sub-sections (6) and (7) shall not apply if a receiver for management has been appointed by a Court pursuant to the provisions of the security agreement.

54. *Surplus or deficiency.*—(1) Where a security agreement secures an indebtedness and the secured party has dealt with the property under section 52 or has disposed of it in accordance with section 53 or otherwise, he shall account for any surplus to any person, other than the debtor, whom the secured party knows to be the owner of the property, and, in the absence of such knowledge, he shall account to the debtor for any surplus, and unless otherwise agreed the debtor is liable for any deficiency.

(2) Where the security agreement purports to be a sale of a general intangible, the debtor is entitled to any surplus or is liable for any deficiency on the disposal of the general intangible by the secured party only, if the security agreement so provides.

55. *Appropriation on full satisfaction.*—(1) A secured party in possession of the property may, after default, propose to appropriate the property in full satisfaction of the obligation secured, and notice of such proposal shall be given to the debtor and to any other person whom such secured party knows to be the owner of the property and, except in the case of consumer goods, to any other person who has a security interest in the property and who has registered a security agreement under this Act or who is known by the secured party in possession to have a security interest in the property.

(2) If any person entitled to notice under sub-section (1) objects in writing within fifteen days after receiving the notice, the secured party in possession shall dispose of the property under section 53, and, in the absence of any such objection, such secured party shall, at the expiration of such period of fifteen days, be deemed to have irrevocably elected to appropriate the property in full satisfaction of the obligation secured, and thereafter is entitled to hold or dispose of the property free of all rights and interests therein of any person entitled to notice under sub-section (1) who was given such notice.

56. *Redemption of the property.*—At any time before the secured party has disposed of the property by sale or exchange or contracted for such disposition under section 53 or before the secured party is deemed to have irrevocably elected to appropriate the property in full satisfaction of the obligation under sub-section (1) of section 55, the debtor, or any person other than the debtor who is the owner of the property, or any secured party other than the secured party in possession, may, unless he has otherwise agreed in writing after default, either—

(a) redeem the property by tendering fulfilment of all obligations secured by the property, or

(b) reinstate the security agreement by paying the sums actually in arrear, exclusive of the operation of any acceleration clause, or by curing any other default by reason whereof the secured party intends to dispose of the property,

together with a sum equal to the reasonable expenses of holding, repairing, processing, preparing the property for disposition and in arranging for its disposition, and, to the extent provided for in the security agreement, the reasonable legal expenses.

57. *Remedies against goods and documents.*—The secured party may enforce the security interest by any method available in or permitted by law and, if the property is or includes a document of title, the secured party may proceed either as to the document of title or as to the goods covered thereby, and any method of enforcement that is available with respect to the document of title is also available *mutatis mutandis* with respect to the goods covered thereby.

58. *Where agreement covers both immovable property and personal property.*—Where a security agreement covers both immovable property and personal property, the secured party may proceed under this Chapter as to the personal property and he may proceed as to the immovable property in accordance with his rights and remedies in respect of the immovable property.

59. *Other rights of secured party who is a bank.*—Where the debtor is in default under a security agreement and a bank is the secured party, the bank has, in addition to any other rights and remedies, the rights and remedies provided in the security agreement and the rights and remedies provided in this Act.

60. *No merger in judgment.*—A security interest does not merge in the judgment merely because a secured party has reduced his claim for the debt to judgment.

61. *Secured party's failure to comply with this Chapter.*—(1) Where a secured party in possession of the property is not complying with an obligation imposed by section 17 or, after default, is not proceeding, in accordance with this Chapter or the account is disputed, the debtor or any person who is the owner of the property or the creditors of either of them or any person other than such secured party who has an interest in the property may apply to the Court having jurisdiction with respect thereto, and the Court may, upon hearing any such application, direct that the secured party comply with the obligations imposed by section 17, or that the property be or be not disposed of, or order an account to be taken or make such other or further order as the Court deems just.

(2) If the disposition of the property has been made otherwise than in accordance with this Chapter, the debtor or any other person entitled to notice under sub-section (6) of section 53 or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss or damage caused by his failure to comply with this Chapter.

62. *Debtor's rights and remedies.*—Where the debtor is in default under a security agreement, he has the rights and remedies provided for in the security agreement, the rights and remedies provided for in this Chapter and in section 17.

63. *Waiver of rights by debtor.*—(1) Except to the extent provided in this Act, the rules stated in the following provisions may not be waived or varied in so far as they give rights to the debtor and impose duties on the secured party—

(i) the provisions in sections 52 and 54 in so far as they require accounting for surplus proceeds of the property;

(ii) the provisions in section 53 dealing with the disposition of the property;

(iii) the provisions in section 55 dealing with the appropriation of the property in discharge of the obligation;

(iv) the provisions in section 56 dealing with the redemption of the property;

(v) the provisions in section 61 dealing with the secured party's liability for failure to comply with the provisions of this Chapter.

(2) Notwithstanding anything contained in sub-section (1), the parties may by agreement determine the standards by which the fulfilment of the rights and duties referred to in the said sub-section is to be measured if such standards are not manifestly unreasonable.

64. *Information from the secured party.*—(1) A debtor may, by a notice in writing, containing an address for reply and sent or delivered to the secured party who is not a bank at the address set forth in the security agreement, or at a more recent address if known, require the secured party to send or deliver to him at the said address —

(a) a statment in writing of the amount of the indebtedness and of the terms of payment thereof as of the date specified in the notice;

(b) a written approval or correction as of date specified in the notice of the itemised list of the property attached to the notice;

(c) a written approval or correction as of the date specified in the notice of the amount of the indebtedness and of the terms of payment thereof; and

(d) a copy of the security agreement;

or any one or more of the foregoing.

(2) The Court may, on an application by a creditor or other person with a legal or equitable interest in the property, direct any secured party to furnish the aforesaid information to any such party.

(3) The secured party is entitled to claim payment of any reasonable charges before he is required to furnish such information and the rules may prescribe the rates for such charges.

65. *Rights and remedies cumulative.*—(1) The rights and remedies referred to in this Chapter are cumulative.

(2) *Floating charge over companies.*—Where a secured party obtains a security agreement in the property of a company or other corporate-debtor, and such security agreement would confer on him a floating charge on the property described in the security agreement in accordance with the law applicable before the coming into force of this Act, the secured party may claim his rights and remedies as the holder of a floating charge in the property, and in such a case, his rights and remedies under the security agreement would be only such as were available to a floating charge holder before the coming into force of this Act.

CHAPTER VII

REGISTRATION

66. *Registration of security interest.*—(1) For the purposes of this Act, registration of a security interest means —

(a) in the case of a security interest in the property of a debtor which is a company, registration under the provisions relating to "Registration of Charges" in the Companies Act, 1956;

(b) in the case of a security interest created over a motor vehicle, registration under section 31A of the Motor Vehicles Act, 1939; and

(c) in the case of a security interest in a fixture and in all other cases, registration under Part III-A of the Registration Act, 1908.

(2) In the case of a security interest in a motor vehicle or in a fixture belonging to a company, perfection of the security interest by registration arises from the date of the registration under the Motor Vehicles Act, 1939, or the Registration Act, 1908, as the case may be. However, enforcement of the rights of a secured party against the property would be subject to the provisions of section 125 of the Companies Act, 1956.

(3) Subject to the provisions of sub-section (2), a security interest is perfected in the property, by registration, when registration is effected in accordance with the provisions of sub-section (1).

67. *Registration under prior law.*—(1) Every security interest that has been recorded on the day prior to the coming into force of this Act under the provisions of the Motor Vehicles Act, 1939, or under the provisions of the Companies Act, 1956, shall be deemed to have been registered and perfected under this Act.

(2) Every security interest relating to a fixture that has been registered as part of the immovable property, to which the fixture is embedded or affixed, under the provisions of the Registration Act, 1908, on a day prior to the coming into force of this Act shall be deemed to have been registered under the provisions in Part III-A of that Act relating to fixtures and perfected under this Act.

(3) Every security interest in the property of the debtor who is not a company, and which does not relate to fixtures or motor vehicles, if already covered by a security agreement registered under the Registration Act, 1908, on a day prior to the coming into force of this Act, shall be deemed to have been registered in Part III-A of that Act for a period of ninety days from the date of coming into force of this Act. After the expiry of such period, the security interest shall not be regarded as so registered unless within this period the secured party applies with the consent of the debtor to the Sub-Registrar having jurisdiction under Part III-A of the Registration Act, 1908, to enter the prescribed particulars relating to the earlier registration in Book III-A to be maintained under that Act.

CHAPTER VIII

AMENDMENTS TO OTHER ACTS

68. The provisions of the Companies Act, 1956, shall stand amended as specified in Schedule I to this Act from the date of coming into force of this Act.

69. The provisions of the Registration Act, 1908, shall stand amended as specified in Schedule II to this Act from the date of coming into force of this Act.

70. The provisions of the Motor Vehicles Act, 1939, shall stand amended as specified in Schedule III to this Act from the date of coming into force of this Act.

71. The provisions of the Transfer of Property Act, 1882, shall stand amended as specified in Schedule IV to this Act from the date of coming into force of this Act.

72. The provisions of the Indian Contract Act, 1872, shall stand amended as specified in Schedule V to this Act from the date of coming into force of this Act.

73. The provisions of the Sale of Goods Act, 1930, shall stand amended as specified in Schedule VI to this Act from the date of coming into force of this Act.

74. The provisions of the Hire-Purchase Act, 1972, shall stand amended as specified in Schedule VII to this Act from the date of coming into force of this Act.

CHAPTER IX

GENERAL PROVISIONS

75. *Extension of time.*—(1) Where in this Act any time is prescribed within which or before which any act or thing must be done, the Court on application may, upon such terms and conditions and with such notice, if any, as the Court may order, upon being satisfied that no interest of any other person will be prejudiced by an extension, extend such time for compliance. However, in the event that it later appears that any such act or thing done within the period so extended has prejudiced the rights which any person acquired before the doing of such act or thing, such act or thing shall be

presumed not to have been done in conformity with this Act for the purpose of ascertaining the rights which such person acquired before the doing of such act or thing.

(2) A copy of an order made under sub-section (1) shall, for the purposes of registration, be attached to the document to which the order relates. The rights of other persons accrued up to the time of the registration of the order made under this section are not affected by the order.

76. *Conflicting provisions.*—Unless otherwise provided in this Act, where there is a conflict between a provision of this Act and any other law for the time being in force, the provision of this Act shall prevail.

77. *Act governs security interest though not the obligation.*—The application of the Act to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Act does not apply.

78. *Government to frame rules.*—(1) For the purpose of carrying out the provisions of this Act, the Central Government shall frame such rules as it may consider necessary from time to time.

(2) Without prejudice to the generality of the foregoing power, the rules may provide for—

(a) the prescribing of forms for use for the purpose of registration of any security interest, including the forms, registers and other records to be maintained by the authorities specified in section 66;

(b) the procedure and the formalities relating to the registration of security interests or security agreements, as the case may be, by the different authorities referred to in section 66;

(c) the prescribing of the duties of the authorities in relation to registration as specified in section 66;

(d) the specifying of the period under the proviso to section 41;

(e) the prescribing of the rate of charges which a debtor or other person may be required to pay to the secured party for furnishing information under section 64;

(f) the prescribing of the period upto which books, documents, records and other papers relating to registration of a security interest shall be preserved by the respective authorities;

(g) any other matter in respect of which the Central Government considers it necessary or advisable to frame rules to carry out effectively the intentions and purposes of this Act.

SCHEDULE I

Amendments to the Companies Act, 1956

I. For the existing section 124, the following shall be substituted:

"124. *'Charge' to include mortgage in this Part.*—In this Part, the expression 'charge' includes—

(a) mortgages of, and charges on, immovable property to which the Transfer of Property Act, 1882, applies; and

(b) security interests in personal property including fixtures to which the Personal Property Security Act, 197 , applies."

II. In section 125, the following shall be inserted as clause (j) of sub-section (4):

"(j) charge on any other personal property of the company, except when it is perfected by possession or otherwise than by registration under the provisions of the Personal Property Security Act, 197 ."

III. In section 130, the following shall be inserted as sub-section (1A):

"(1A) The Registrar shall make the entry in the Register as required by sub-section (1) within seven days from the date on which the prescribed particulars are filed with him under sub-section (1) of section 125."

IV. In section 132, after the words "stating the amount thereby secured" the following shall be inserted:

"and specifying the date on which the particulars were entered on the Register of Charges as required by section 130".

SCHEDULE II

Amendments to the Registration Act, 1908

I. The following shall be inserted as Part III-A after Part III of the Act:

"PART III-A

Of registration of documents relating to the creation of security interests in personal property

22A. The provisions of this Part shall be applicable to the registration of a security interest in personal property including fixtures in accordance with the Personal Property Security Act, 197

22B. Nothing contained in this Part shall be applicable to the registration of a security interest in the property of a 'company' as defined in the Companies Act, 1956, or over a 'vessel' as defined under the Merchant Shipping Act, 1959, or over a 'motor vehicle' as defined under the Motor Vehicles Act, 1939, or over an aircraft.

22C. Registration of a security interest in personal property (other than fixtures) may be effected only in the office of the sub-registrar in whose sub-district the debtor ordinarily carries on business, or if he does not carry on business, he ordinarily resides.

Explanation:—A debtor who has a Permanent Account Number for purposes of income-tax is deemed to carry on business at the place where he has a Permanent Account Number.

22D. (1) An application for registration of a security interest in personal property other than a fixture, shall contain the following particulars:

(a) the name, description and address of the debtor;

(b) the name, description and address of the secured party;

(c) the date of execution of the security agreement;

(d) a description of the personal property sufficient to identify it; and

(e) the terms and conditions of the security agreement.

(2) The application shall be accompanied by the security agreement, if any, by which the security interest is created or evidenced.

(3) The sub-registrar shall enter the particulars relating to the security interest, furnished under sub-section (1), in Book 3A specified in section 51.

(4) After making the entry as required by sub-section (3), the sub-registrar shall issue a certificate of registration containing the particulars relating to the security interest, furnished under sub-section (1), and specifying the date on which the particulars were entered in Book 3A as provided by sub-section (3), and shall return the security agreement accompanying the application under sub-section (2).

(5) For purposes of priority under the Personal Property Security Act, 197 , the registration shall take effect from the date specified in the certificate of registration as the date on which the particulars were entered in Book 3A.

(6) Book 3A shall be open for inspection by any person on the payment of the prescribed fee.

22E. (1) An application for the registration of a security interest in a fixture may be presented for registration in the office of the sub-registrar within whose sub-district the immovable property of which the fixture forms part is situate

(2) An application for the registration of a security interest in a fixture presented under sub-section (1) shall contain in addition to particulars contained in sub-section (1) of section 22D, a description of the immovable property of which the fixture forms part, in accordance with sections 21 and 22.

(3) The application shall be accompanied by the security agreement, if any, by which the security interest is created or evidenced.

(4) The sub-registrar shall enter the particulars so furnished relating to the security interest in Book 1, specified in section 51.

(5) After making the entry as required by sub-section (4), the sub-registrar shall issue a certificate of registration containing the furnished particulars relating to the security interest and specifying the date on which the particulars were entered in Book 1, as provided by sub-section (4) and shall return the security agreement accompanying the application under sub-section (3).

(6) For purposes of priority under the Personal Property Security Act, 197 , the registration shall take effect from the date specified in the certificate of registration as the date on which the particulars were entered in Book 1.

(7) Book 1 shall be open for inspection by any person on the payment of the prescribed fee.

22F. (1) Notwithstanding anything contained in this Act, an application for registration of a security interest in personal property may, where the secured party is a bank, be sent by registered post acknowledgement due for the purposes of registration.

(2) The sub-registrar after registration shall return the security agreement accompanying the application, if any, and send the certificate of registration by registered post acknowledgement due, if so desired by the bank.

22G. Without prejudice to the generality of the provisions contained in this Part or of the Personal Property Security Act, 197 , Part V, sections 34 and 35 of Part VI and Parts VII to X (both inclusive) of this Act shall be inapplicable to the registration of a security interest in personal property including a fixture.

22H. In this Part the expressions "bank", "debtor", "fixture", "personal property", "secured party", "security agreement" and "security interest" shall have the same meaning as they have under the Personal Property Security Act, 197 ."

II. In section 51—

(a) the following words shall be inserted after the words "Register of non-testamentary documents relating to immovable property" in the reference to Book 1 in item A of sub-section (1) of this section:

"and fixtures".

(b) the following shall be inserted after entry B in sub-section (1) :

"Book 3A: Register of non-testamentary documents relating to personal property other than fixtures".

SCHEDULE III

Amendments to the Motor Vehicles Act, 1939

I. In section 24, the following shall be substituted for the proviso to sub-section (1):

"Provided that where a motor vehicle is jointly owned by more than one person, the application shall be made by one of them on behalf of all the owners, and where the motor vehicle is owned by a firm, the application shall be made by a partner of the firm in the name of the firm, and such applicant shall be deemed to be the owner of the motor vehicle for the purposes of the Act."

II. In section 30, after the words "original registering authority" occurring in sub-section (2), the following shall be inserted:

"and to any person whose name is noted in the Certificate of Registration as the person with whom the owner has entered into a security agreement."

III. For the existing section 31A, the following shall be substituted:

"31A. *Special provisions relating to security interests in motor vehicles.*— (1) An application may be made in Form EE as set forth in the First Schedule, either at the time when an application for registration of a motor vehicle is made under section 24 or at any other time, to the registering authority for the registration of a security interest in a motor vehicle.

(2) The application shall be accompanied by the Certificate of Registration, if any, relating to the motor vehicle.

(3) The registering authority shall enter the particulars so furnished relating to the security interest in the Register of Motor Vehicles and shall note in the Certificate of Registration the existence of the security interest in the prescribed manner.

(4) The Register of Motor Vehicles shall be open to inspection to any person on the payment of the prescribed fee.

(5) Anyone entering into any transaction relating to a motor vehicle shall be deemed to have notice of the contents of the Register of Motor Vehicles and of the Certificate of Registration pertaining to that motor vehicle.

(6) Any entry made in the Register of Motor Vehicles and the Certificate of Registration under sub-section (3) may be cancelled by the registering authority on proof of termination of the security interest.

(7) No entry regarding the transfer of ownership of any motor vehicle which is subject to a security agreement shall be made in the Register of Motor Vehicles or a Certificate of Registration except with the written consent of the person whose name appears in the Register of Motor Vehicles and the Certificate of Registration as a person entitled to a security interest in the motor vehicle.

(8) Where the person whose name appears in the Register of Motor Vehicles and a Certificate of Registration as the person entitled to a security interest in the motor vehicle satisfies the registering authority that he has taken possession of the vehicle, being entitled to do so, owing to the default of the owner, the registering authority may, after giving the owner an opportunity to make such representation as he may wish to make (by sending to him a notice by registered post acknowledgement due at his address entered in the Register of Motor Vehicles or the Certificate of Registration) and notwithstanding that the Certificate of Registration is not produced before it, cancel the Certificate of Registration and issue a duplicate thereof to the person aforesaid.

(9) Any number of security interests in respect of the same motor vehicle may be registered in pursuance of this section.

(10) This section shall not apply to a security interest in motor vehicles held as inventory.

(11) The expressions "security agreement", "security interest" and "inventory" in this section shall have the same meaning as in the Personal Property Security Act, 197 ."

IV. In section 32—

(a) the following shall be inserted as the second proviso to sub-section (1):

"Provided further that the registering authority shall not give his approval without giving a reasonable opportunity to the person whose name appears in the Register of Motor Vehicles as a person entitled to a security interest in the vehicle to state his objections, if any, and without considering the objections, except where the said person has already consented to the proposed alteration."

(b) the following shall be inserted as the second proviso to sub-section (2):

"Provided further that the said time limit of seven days shall be read as thirty days in a case to which the second proviso to sub-section (1) applies, except where the person referred to in that proviso has already consented to the proposed alteration."

V. In section 29, after sub-section (2), the following shall be inserted as sub-section (2A):

"(2A) The registering authority shall give any person whose name is noted in the Certificate of Registration as the person with whom the owner has entered into a security agreement, information regarding such transfer of registration of the vehicle by sending to him a communication by registered post acknowledgement due at his address entered in the Certificate of Registration."

VI. In the First Schedule to the Act, the following shall be inserted as Form EE :

"FORM EE

(Section 31A)

1. Registered Number:
2. Brief description of vehicle:
3. Name of owner:
4. Date of creation of security interest :
5. The amount secured under the agreement:
6. Person/s entitled to the security interest, occupation, description and address:

Date: Signature of the Owner.

Signature/s of the Person/s entitled to the security interest."

SCHEDULE IV

Amendments to the transfer of property act, 1882

I. The following shall be inserted as section 58A:

"58A. Nothing contained in this Chapter shall affect a security interest over a fixture, to which the provisions of the Personal Property Security Act, 197 , are applicable."

II. In section 130, the following shall be substituted for the existing sub-section (2):

"(2) The rights and remedies arising on the transfer of an actionable claim shall be the same as those available to the assignor and the assignee on the transfer of a general intangible under the Personal Property Security Act, 197 ."

III. Sections 131 and 132 shall be deleted.

SCHEDULE V

Amendments to the Indian Contract Act, 1872

I. The following shall be substituted for the existing section 173:

"173. *Rights of pawnors and pawnees.*—The rights of pawnors and pawnees shall be those as laid down in the Personal Property Security Act, 197-, in the case of a secured party having possession of the property and of the debtor."

II. Sections 174, 175, 176 and 177 shall be deleted.

SCHEDULE VI

Amendments to the Sale of Goods Act, 1930

In section 30, the following shall be inserted as sub-section (3):

"(3) Nothing contained in this section shall affect the rights of a secured party having a security interest in the goods or in the document of title to the goods under the Personal Property Security Act, 197-."

SCHEDULE VII

Amendment to the Hire-Purchase Act, 1972

The following shall be substituted for the existing section 31 :

"31. *Agreements to which this Act does not apply.*—This Act shall not apply to—

(a) any hire-purchase agreement made before the commencement of this Act;

(b) any hire-purchase agreement relating to motor vehicles as defined in the Motor Vehicles Act, 1939;

(c) any hire-purchase agreement under which the hire-purchase price exceeds Rs. 25,000;

(d) any hire-purchase agreement which is made by or on behalf of a body corporate as the hirer of the goods to which the agreement relates; and

(e) any hire-purchase agreement in which the hirer is a dealer.

Explanation :—"Dealer" in this clause means any person who carries on the business of buying or selling goods."

ANNEXURE 8

INSTITUTIONS AND INDIVIDUALS WHOSE VIEWS ON THE PROJECT REPORT ON PERSONAL PROPERTY SECURITY LAW WERE ELICITED

1. All Scheduled and Non-Scheduled Commercial Banks
2. Indian Banks' Association
3. Regional Rural Banks (20)
4. All State Co-operative Banks
5. Co-operative Urban Banks (30)
6. All State Financial Corporations (including the Tamilnadu Industrial investment Corporation Ltd.)
7. Industrial Development Bank of India
8. Industrial Finance Corporation of India
9. Industrial Credit & Investment Corporation of India Ltd., Bombay.
10. Export Credit & Guarantee Corporation Ltd., Bombay
11. Maharashtra Small Scale Industries Development Corporation Ltd.
12. Industrial Reconstruction Corporation of India Ltd., Calcutta
13. Federation of Indian Chambers of Commerce & Industry, New Delhi
14. Associated Chambers of Commerce & Industry of India, New Delhi.
15. Federation of Andhra Pradesh Chambers of Commerce & Industry, Hyderabad.
16. Chambers of Commerce/Industries (77)
17. Federation of Indian Hire Purchase Associations, New Delhi.
18. Hire-Purchase Association, Calcutta
19. Auto Hire-Purchase Association, Secunderabad
20. Uttar Pradesh Hire-Purchase Companies Association, Kanpur.
21. Upper India Hire Purchase Companies' Association Ltd., New Delhi.
22. Western India Hire Purchase Association, Bombay
23. Punjab & Haryana Finance Companies' Association, Jullundur City
24. Jammu & Kashmir Financiers Association
25. South India Hire Purchase Association, Madras
26. Association of Indian Automobile Manufacturers, Bombay
27. Mercantile Credit Corporation Ltd., Madras
28. Laxmi Finance Corporation, Calcutta
29. Ganeshnarayan Brijlal Ltd., Calcutta
30. Instalment Supply Pvt. Ltd., New Delhi
31. Jayabharat Credit & Investment Co. Ltd., Bombay
32. Bombay Goods Transport Association, Bombay

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33. All-India Motor Transport Congress, New Delhi
34. Maharashtra Apex Corporation Ltd., Manipal
35. Sundaram Finance Ltd., Madras
36. All-India Bank Employees Association, New Delhi
37. Shri Saraiya R. G., Chairman, Banking Commission, Bombay
38. Shri Ramanand Rao N., Member, Banking Commission
39. Dr. Datta Bhabatosh, Member, Banking Commission
40. Shri Pendharkar V. G., Member-Secretary, Banking Commission and now Economic Adviser, Central Bank of Tanzania
41. Shri Narayan D. S., General Sales Manager, Tata Engineering and Locomotive Co. Ltd., Bombay.
42. Shri Narayanachari N. S., Former Senior Counsel of International Monetary Fund, Madras
43. Shri Peri Sastri, Joint Secretary and Legislative Counsel, Ministry of Law, Justice and Company Affairs, Government of India, New Delhi
44. Shri Vijayaraghavan T. T., Madras
45. Shri Pardiwala C. H., Crawford Bayley & Co., Bombay
46. Shri Santhanam T. S., Managing Director, T. V. Sundaram Iyengar & Sons Ltd., Madras
47. Shri Kapadia G. P., Chartered Accountant, Bombay

FOREIGN EXPERTS

48. Mr. Carl W. Funk, U.S.A.
49. Prof. Herbert Wechsler, Director, American Law Institute, New York
50. Mr. Paul A. Wolkin, Assistant Director, American Law Institute, U.S.A.
51. Mr. James E. Faris, Director, Department of Financial Institutions, State of Indiana, U.S.A.
52. Mr. Norris Darrell, President, American Law Institute, New York.
53. Mr. William J. Pierce, Executive Director, National Conference of Commissioners on Uniform State Laws, Chicago, U.S.A.
54. Prof. Robert Braucher, Law School of Harvard University, U.S.A.
55. Dr. Walter D. Malcolm, Bingham, Dana and Gould, Massachusetts, U.S.A.
56. Mr. Maurice Megrah, Q.C., London
57. Prof. R. M. Goode, Queen Mary College, University of London
58. Prof. A. L. Diamond, Law Commission, London
59. Mr. D. T. Hayles, Solicitor and Deputy Principal, Midland Bank Ltd., London
60. Mr. M. L. Saunders, Treasury Solicitor and Legal Adviser, Department of Energy, London
61. Mr. H. H. Marshall, Deputy Director, British Institute of International and Comparative Law, London
62. Mr. F. R. Ryder, Group International Legal Adviser, Midland Bank Ltd., London

63. Mr. M. N. Karmel, Deputy Secretary, British Bankers Association, London
64. Prof. Ronald C. C. Cuming, University of Saskatchewan, Canada
65. Mr. G. H. H. Read, Legal Adviser, Canadian Bankers' Association
66. Mr. J. F. Riegert, Secretary-Treasurer, Canadian Bankers' Association
67. Prof. T. G. Ison, Faculty of Law, Queen's University, Ontario, Canada
68. Prof. J. S. Ziegel, University of Toronto, Ontario, Canada
69. Prof. Arthur Rogerson, South Australia, Australia
70. Mr. R. J. Ellicott, Attorney-General of Australia, Canberra, Australia
71. Hon'ble Mr. R. Clenister, Secretary to the Law Department, State Law Offices, Melborne, Victoria, Australia
72. Hon'ble Mr. V. F. Wilcox, Q.C., M.P., Attorney-General, Melborne, Victoria, Australia
73. Prof. Mary E. Hiscock, Reader in Law, University of Melborne, Australia
74. Prof. Derek Roebuck, Dean of the Faculty of Law, University of Tasmania, Australia
75. Prof. David E. Allan, Dean of the Faculty of Law, Monash University, Australia
76. Mr. David Geddes, Secretary-General, LAWASIA, c/o University of New South Wales, Kensington, Australia
77. Mr. M. M. Bryson, Secretary, Contracts and Commercial Law Reform Committee, Wellington, New Zealand
78. Mr. Yves Derains, Secretary, International Chamber of Commerce, Paris.
79. Mr. B. S. Wheble, Simplification of International Trade, Procedures Board, London.
80. Mr. Willem Vis, Chief, International Trade Law Branch, United Nations, New York
81. Mr. Chun Pyo Jhong, Deputy General Counsel, Asian Development Bank, Manila, Philippines
82. Shri Shah M. J., Chief, Maritime Legislation Section, Shipping Division, UNCTAD, Geneva
83. Mr. A. Broches, Vice-President and General Counsel, International Bank of Reconstruction and Development, Washington.

ANNEXURE 9

INSTITUTIONS AND INDIVIDUALS WHO HAVE OFFERED COMMENTS ON THE PROJECT REPORT ON PERSONAL PROPERTY SECURITY LAW

1. Syndicate Bank
2. State Bank of Indore
3. State Bank of Bikaner and Jaipur
4. Punjab National Bank
5. Tanjore Permanent Bank Ltd.
6. Bharat Overseas Bank Ltd.
7. Purbanchal Bank Ltd.
8. Punjab and Sind Bank Ltd.
9. Hindustan Commercial Bank Ltd.
10. Grindlays Bank Ltd.
11. Chartered Bank (through the Indian Banks' Association)
12. Bank of America
13. Goa Urban Co-operative Bank Ltd.
14. Gujarat State Co-operative Bank Ltd.
15. Indian Banks' Association
16. Industrial Development Bank of India
17. Industrial Finance Corporation of India
18. Industrial Reconstruction Corporation of India Ltd.
19. Jammu & Kashmir State Finance Corporation
20. Mysore State Financial Corporation
21. Maharashtra State Financial Corporation
22. Federation of Indian Hire-Purchase Associations
23. Associated Chambers of Commerce and Industry of India
24. Maharashtra Apex Corporation Ltd.
25. Shri T. S. Santhanam, Managing Director, T. V. Sundaram Iyengar & Sons Ltd., Madras
26. Shri T. T. Vijayaraghavan, Madras
27. Shri T. D. Kansara (through the Federation of Indian Chambers of Commerce & Industry)
28. Dr. Bhabatosh Datta, Member, Banking Commission.

FOREIGN EXPERTS

29. Prof. R. M. Goode, Queen Mary College, University of London
30. Mr. Maurice Megrah, Q.C., London
31. Prof. Ronald C. C. Cuming, University of Saskatchewan, Canada
32. Mr. Haddon Storey, Attorney-General, Victoria, Australia
33. Mr. Walter D. Malcolm (through Mr. Robert Haydock, Jr., Bingham, Dana and Gould, Boston, Massachusetts, U.S.A.).
34. Mr. R. J. Ellicott, Attorney-General of Australia, Canberra.
35. Mr. J. H. Greenwell of Attorney-General's Department of Canberra.

COMMENTS ON THE PROJECT REPORT ON PERSONAL PROPERTY SECURITY LAW FROM SOME FOREIGN AUTHORITIES

(1) PROFESSOR R. M. GOODE, O.B.E., LLB., Faculty of Laws, Queen Mary College, University of London, Mile End Road, London (vide his letter No. RMG/NJ/71, dated 13th September 1976 to the Secretary, Banking Laws Committee).

"Thank you for your letter of 19th July. I have now had an opportunity to read the very interesting Project Report on Personal Property Security Law and whilst in the time available I have been able to do little more than concentrate on general precepts (to do full justice to the report would require a detailed examination over many months) I hope that the following observations will be of some assistance.

I do think that those concerned with the preparation of the draft bill annexed to the report are to be congratulated on a very concise presentation of what is essentially a complex measure covering a very wide range of secured transactions. My own comments and criticisms necessarily reflect my personal view of what is necessary to maintain an equitable balance in priority conflicts and though on certain points I have ventured to express disagreement with the proposals, I am of course aware that there may be factors relevant to the financial structure and system in India which account for the proposals and of which I myself have no personal knowledge.

1. I agree with many of the principles embodied in the draft bill—which is of course modelled on Article 9 of the Uniform Commercial Code, already adopted in Ontario and reaching the stage of a model bill and report thereon in British Columbia—but the utility of the proposals is undoubtedly weakened by the fact that for administrative reasons it is not proposed to introduce a so-called register. This has several regrettable consequences. In the first place it means that a variety of existing registration systems are maintained in force, each governed by distinct statutory requirements thus considerably diluting the process of unification of security interests which a law of this kind is designed to avoid. As a corollary it precludes adoption of the extremely useful "notice filing" concept embodied in Article 9. Further, the maintenance of the existing registration systems does, I suspect, have the effect of continuing in force requirements for fairly precise identification of the subject matter of a projected security interest, thereby inhibiting a blanket filing covering designated classes of security rather than specific items of security.

2. Following upon the first point, my view is that it is much fairer to all concerned to facilitate a general filing—so that a bank, for example, can file a financing statement covering security arising from all transactions of a designated type as opposed to a specific transaction—than to equate a bank whose security is unregistered with other creditors whose security has been registered.

3. There is much to be said for extending the registration system to cover instruments. One must, of course, give priority to a creditor whose interest in an instrument is perfected by possession and due negotiation against one whose interest is perfected merely by filing, but that is not a good ground for excluding instruments from the registration system altogether. There are various situations in which it may be necessary to protect a security interest in an instrument against parties other than a holder. For example, if a lender makes advances on the security of chattel paper such as hire-purchase and conditional sale agreements the lender may wish to obtain a security interest in cheques and other instruments paid by the debtor to the borrower. Again, if loans are made on the security of accounts and despite notice of assignment the debtor sends a cheque to the assignor instead of the secured party it seems not unreasonable that the cheque should be capable of subjection to a registered interest that would operate against any third party other than a holder in due course.

4. On page 20 I would suggest that the definition of "fungibles" be altered by deleting the words "nature or usage of trade" and substituting "the terms, express or implied, of the security agreement". I am aware that the definition follows that given in Section 1-201 of the Uniform Commercial Code but I have always felt that definition to be misconceived. Whenever an article is a fungible is determined not by its physical characteristics but by the terms of the obligation owed with respect to it, that is to say, the terms on which it is held. Any article is capable of being a fungible if the parties so agree, whether it consists of a quantity of grain or a motor-car. Conversely, any article may be agreed to be held *in specie*. If I deliver a quantity of grain to another as security and stipulate that I expect to get the same grain returned to me and not merely its equivalent, the law gives effect to this stipulation. Accordingly my view is that whenever an article is to be returned *in specie* to the debtor or is to be accounted for by the return of an equivalent quantity and kind is purely a matter of contract between the secured party and the debtor and is nothing to do with the nature of the subject matter except insofar as this may raise a presumption that the intention is to hold the article as a fungible and not *in specie*.

5. Section 12 requires a security agreement to express a maximum to be secured if it is to secure further advances. I should have thought this restriction was undesirable. In England the most common form of bank security is that which is given to secure all advances without limit and it is not clear to me what useful purpose is served by requiring a security agreement to state a maximum. If Indian law adopts the principle of *Hopkins* v. *Rolt* the party taking security for future advances does not obtain a monopoly over a subsequent encumbrancer because under that rule he is postponed to that encumbrancer as regards advances made after notice of the latter's security interest.

6. Section 26 seems to me to be unfair to other potential secured creditors, e.g. receivables financiers. If, as suggested earlier, the registration system were extended to permit registration of security interests in instruments the problem would be easily avoided. I would add that I am not clear why it is necessary for the bank's security interest to be "deemed to be perfected" in the light of the provisions of Section 32(2), which appeared to give an unperfected security interest in favour of a bank very much the same priority as if it were a perfected security interest. I do in fact have an objection to raise to the principle of Section 32(2)(i) but at this point I am merely drawing attention to what appears to me to be a slight inconsistency in conception

in the two provisions. Section 30 sets out general priority rules based on the 1962 version of Article 9. The Crowther Committee at page 580 in the second volume of its report, drew attention to a defect in priority rule (b) pointing out that the rule was unsatisfactory where one interest was perfected by filing and the other was not. For example, if A files and afterwards B perfects by possession before A has perfected it is hard to see why B should be able to jump ahead of A when he had notice of A's interest as a result of A's filing. It is interesting to note that those concerned with the review of Article 9 had reached the same conclusion and that the priority rule in Section 9-312(5) as amended now has the effect that if one of the interests was perfected by filing that filing fixes the priority where the filed interest is subsequently perfected even if meanwhile another party had perfected by possession.

7. Section 32(2) seems to me to go much too far. I appreciate that on grounds of policy it is desired to strengthen the position of the banks but it is surely a strong measure to say that a bank whose security interest in an asset is unperfected shall have priority over a bona fide purchaser for value in the ordinary course of business. After all, a bank which takes security over imported goods or their inventory knows full well that these are to be disposed of in the ordinary course of business and indeed that without such disposal its customer would not be able to repay the loan. It is generally considered essential to the free flow of trade that a purchaser in the ordinary course of business should get a good title. That has been a cardinal rule in all common law countries under Factors Acts, and indeed Section 9-307(1) of the Code goes further still and gives priority to the buyer in the ordinary course of business even where the security interest has been perfected. I cannot see why a bank cannot adequately protect its position by filing in the same way as any other secured creditor. If there is some technicality in the existing law which prevents this then surely it would be better to remove the technicality.

8. I am not clear why Section 35(2) excludes transfers in satisfaction of a money debt. I can quite see that a transfer as security for an existing debt should be excluded because this is not a transfer for value. On the other hand transfer in satisfaction of a debt is a transfer for value because the debt is thereby extinguished. Accordingly the effect of Section 35(2) could be most unfortunate because it would mean that a creditor who agreed to accept goods in satisfaction of a debt owed to him would lose his right to demand payment of the debt but would at the same time find that his rights were subordinated to those of a secured creditor even, apparently, if the security interest was not perfected. I should add that exclusion of transfers in satisfaction of a debt from the scope of Section 35(2) would not substantially weaken that sub-section because there would not be many cases in which a transfer in satisfaction of a debt is a disposition in the ordinary course of business.

9. Section 44(3) seems to me rather hard on the assignee and potentially productive of dispute. What is "proof"? and who is to be the judge whether what is tendered as proof is satisfactory? Is a debtor expected to gauge the effect of an instrument relied on as an assignment? I do not myself see the necessity for the requirement as to proof. Surely a simpler and fairer solution is to allow the debtor to interplead and leave it to the court to determine which of the rival claimants has priority.

10. What is the rationale of Section 47(2)? The purpose of registration (which is the primary method of perfection) is to give notice to third parties of the existence of the security interest. Why should the failure to take this step (which has no relevance to the debtor himself, who is obviously aware of the security interest) affect the secured party's ability to pursue remedies against a debtor who is not insolvent?

11. My only comment on the place of the floating charge in any new system is that if the filing system were to permit registration of security over categories of assets (including "all assets") this section would be unnecessary, since the combination of the ability to file on assets generally and Section 8(a) (by which parties are free to agree to the time of attachment) would give the same effect to a floating charge as it now possesses, but within the framework of the new system."

(2) Mr. MAURICE MEGRAH, Q.C., 5, Paper Buildings, Temple, London:

(a) *his letter dated 2nd August 1976 to the Secretary, Banking Laws Committee*

"This is to acknowledge receipt of your letter of July 19 and your Project Report on Personal Property Security Law. You ask me to look into the scheme in its broad perspective and to comment at my early convenience. You will appreciate that I have *by no means digested the Report* and for that reason it may be idle for me to comment at all until I have finished reading and digesting. I have so far got only as far as s.44 and it may well be that when I have read the rest the comments I would make now will be confounded. However I give them to you for what they are worth. You will understand that what I have to say will take the form largely of asking questions, for I *cannot know* what *were the bases* on which the draft statute was formed.

The basic scheme is pretty comprehensive and is rightly based on what you call perfection of a security interest either by possession or registration. I have few comments to make on the Report, but I am a little puzzled by your statement in paragraph 28 that "it will be more appropriate to deal with the security interest over motor vehicles under the personal property security law than to regulate them as a form of hire purchase finance.". Is this because your Hire Purchase Act, 1972 is not yet in force and may never be? In paragraph 32 you give additional benefit to banks as opposed to unperfected security interests of holders who are not banks. This is interesting, especially as you define bank by reference to the Banking Regulation Act, 1949, as extended by the Central Government. However it is the draft statute which gives rise to my comments. The references are to the sections.

S. 2: I am somewhat uncertain of the combined effect of sub-clause (iv) - Building Materials, and sub-clause (xii) - fixtures. I would have thought that, apart from "goods that are or become so incorporated or built into a building that their removal therefrom would necessarily involve the removal or destruction of some other part of the building ....." the rest of the definition would come better under fixtures unless these latter are in fact something different, of which I am not sure.

I am not sure that sub-clause (ix) is altogether clear; is the first part intended to include a surety?

In sub-clause (xiv), does the 'future property' pertain to the property which is the subject of the security agreement?

Sub-clause (xv) defines 'general intangibles'; are there any intangibles which are not general ?

Sub-clause (xvi) speaks of 'movable properties'; should this be defined ?

In sub-clause (xvii), there is a reference to 'shares, stocks, warrants, bonds, debentures or the like or any other writing that evidences a right to the payment of money'; do shares and stock fall within this category ? They cannot be transferred by delivery with any endorsement or assignment ?

Sub-clause (xx) defines 'negotiable document of title'; is this not a negotiable instrument ? In the United Kingdom, at any rate, a share warrant is not a negotiable instrument unless it is to bearer.

Sub-clause (xxiv) says that 'proceeds' means personal property in any form; I do not understand this. Is there a typing error ?

As regards Sub-clause (xxv), can there be a security interest without a security agreement ? If, for instance, a borrower deposits title deeds as security, there is in the United Kingdom an equitable mortgage without anything being put into writing. The same would apply to goods which were the subject of a pledge, if the goods were such as could be physically handed over.

Section 3(a): what is meant by 'in substance' ? it is not suggested that a trust receipt creates a security ? the security interest, I imagine, lies in the fact that the trust receipt derives from a pledge.

Section 9 : I imagine that 'third parties' includes sureties.

Section 10(1): 'future property' by definition does not include property in existence at the time of the execution of the security agreement but which does not come into the ownership of the debtor until later ?

Section 11:. I am not sure of the reason why the future property should not be security for a past, but existing, debt.

Section 13: does 'bailee' at the end of the section mean a bailee from the secured party ?

Section 15: under the Negotiable Instruments Act, 1881, what are the defences which may be set up against a holder in due course ?

Section 21: when does a security interest attach ? Do all three (a), (b) & (c) ; of s.8 have to apply.

Section 22: I am not clear why a security agreement to secure future advances is subject to a maximum; and would there be any question of postponement if the lender were the same in each case ?

Section 26: I understand s.23, but do not follow why an instrument or a negotiable instrument of title should not come into possession for thirty days.

Section 27(1): Would not the security interest continue in any event so long as the debt it covered was still existing; why does it matter whether or not the disposition was authorised by the secured party ? I assume that the sale or other disposition could not be completed so long as the security was in the hands of the secured party. This relates in a sense to my enquiry regarding s.26.

Section 28(1): Why does a negotiable document of title need to be perfected to create a security interest; can it not be simply transferred ?

Section 35: would not a buyer or lessee be acting in bad faith if he ignored the fact that the subject matter of the sale or lease was the subject of a security interest; would he not automatically know that the seller or lessor was breaching his security agreement ? I find this sub-section and also sub-section (2) a little hard to follow.

Section 36: the earlier security interest is, I imagine, in the same instrument.

Section 39: I am finding this section hard to follow.

August 23, 1976

You will see that this letter was dated August 2, the reason for the delay in completing it is that I have been physically out of action since then on account of a crack in my thigh bone, which has exhausted me. I am going away now to try to recover and I shall not be able to tackle your report again until I return in three weeks' time. I am very sorry not to have done more but you will readily understand. I shall write again some time in September. I think I have understood the pattern of your draft legislation, but I shall know more when I have completed studying it. I do not expect an answer to my questions unless they raise matters of importance."

(b) *his letter dated 26th August* 1976 *to the Secretary, Banking Laws Committee*

"I have been able to continue my digestion of your Report and I offer the following further comments. I hope you will not think I am presumptuous in raising these questions, for I know that they will have been well thought out and it is probably my own inadequacy which makes me fail to understand.

Section 38: I assume that a security interest for purchase money may be perfected either by possession or registration according to the nature of the security. I am not sure of the reason for the priority in respect of a transfer not in the ordinary course of business.

Section 39 (b): A security interest for purchase money in inventory entails registration, I imagine. I do not see the point of giving such an interest priority over a conflicting interest if the holder of the latter perfects his security interest before the purchase money secured party registers his; I see that there are exceptions but I do not altogether follow. Is (b)(i) not in conflict with (a) ?

Section 40: Notwithstanding the interest for purchase money was perfected later than another security interest in the same property ?

Section 41: Again, I do not see the reason for the priority, especially if the later interest (the bank's) was taken with knowledge of the earlier one.

I think that I must be reading all these sections wrongly. However,

Section 42(3): Why the priority (a) over a person who had a registered interest in immovable property under 42(2); cannot the subsequent purchaser search the register before he buys ?

Section 43: As the security interest in sub-s. (1) is subordinate to the interest of 2(a), what is the lesser interest visualised in 43(1)(a); "the claim

of any person in respect of the whole"? And why should not any perfected security interest which is registered not take priority over a subsequent purchaser whether bona fide or not?

Section 44(1): I suppose that the documents of title and instruments which are excluded from 'general intangibles' are negotiable, but this is not altogether clear when the definitions in s. 2(xi) and (xvii) are considered; would any other be included?

(2): "without material adverse effect upon the assignee's rights" will surely give difficulties in interpretation. I would have thought that the consent of the assignees to any modification would be necessary to any change without regard to whether or not the change was material. According to the terms of the assignment would not the assignee have a right of action against the assignor upon any modification or substitution? I rather think that this sub-section is too general to be clearly understood.

(4): I do not see why this should be so; is the sub-section designed to prevent a fraud by the assignor on the assignee?

Section 45: Should the word 'equally' in the 7th line be deleted; otherwise I do not understand the last part of the section?

Section 46(2): I do not see how anyone can have a lien over goods not in his possession; he may have a charge?

Section 48(a): is not (a) subject to 47(2); 'secured party' in the former cannot include a secured party under the latter (47(2)); why the reference to 'breach of peace'. It would seem as if this sub-section applies to goods only.

(b): how can the secured party "render the goods temporarily unusable" and may he do so only if it can be done without removal?

Section 49: I can understand that this tries to remove difficulties from legal process, but is sub-s. (1) not likely to lead to trouble?

Section 52(1): Does this in effect require the obligers on general intangibles to assign to the secured party, the assignees being the owners; what is the reason for the words "whether or not the assignor thereupon making collections on the property". Surely the obligors can only pay the assignee the proceeds of debts which they collect after notice?

(2): I do not understand the last part of the sub-section from the word 'but'; does it mean that the obligors may set up any set-off or counterclaim they may have against the holder of the instrument?

Section 53(8): Why is the permission of the Court necessary; does this not put a time clog on the sale?

I do not comment beyond this; it seems clear and I do not know the statutes referred to at the end.

I am sorry that this is so scrappy. It may also be not very sensible. I put my comments in the form of questions because this must indicate at least what is in my mind. But, as I have said before, not knowing the background and the reasons for the draft statute, I could be completely beside the mark. In any event, if there is anything more that I can do, I shall be very happy."

(3) Prof RONALD C. C. CUMING, College of Law, University of Saskatchewan, Saskatoon, Canada (vide his letter dated 12th August 1976 to the Secretary, Banking Laws Committee).

"Thank you for your letter of July 22 and the enclosure.

Pursuant to the request contained in your letter, I have examined the proposals contained in the Project Report to the Banking Laws Committee of the Government of India. Due to the urgency noted in your letter, I have not undertaken a detailed study of these proposals. I have simply noted some of the major areas of departure between the India proposals and the Saskatchewan proposals.

Since writing to you last, the Saskatchewan Law Reform Commission issued its report in this area. The report was prepared by me. I am sending to you under separate cover a copy of this report. The report recommends an Act which in most respects follows the Canadian Bar Association model. However, there are some significant differences and a very large number of minor differences.

One of the major differences between the Saskatchewan and Canadian Bar models is that the Saskatchewan model contains extensive provisions dealing with the floating charge. See Saskatchewan Act, sections 12(1), 15, 22(4). I note in the India report, the statement that floating charges were left out of the scheme of the Act. However, I do note that in section 3 of the India Act floating charges are mentioned as being included in the Act.

The Saskatchewan Act also applies to long term leases on the assumption that the same problems of deception are created under leases that arise under security agreements and therefore registration is required.

All of the Canadian models, including the proposed Saskatchewan Act have not adopted sections equivalent to sections 11 and 13 of the India Act. It was our opinion that these provisions were included in the American Uniform Commercial Code to deal with problems peculiar to American bankruptcy law. These problems have never developed in Canadian jurisprudence and specific provisions dealing with them were unnecessary.

I note that the India Act contains provisions (section (12) dealing with future advances. In particular it provides specific priority rules. The Saskatchewan Act has done the same thing. However, different priority rules have been adopted. See Saskatchewan Act sections 14, 22(2), 30(7) and 35(4).

I note that under section 24 of the India Act, registration perfects a security interest in any type of future property. This is quite different from the North American legislation. Under the Canadian models, it is not possible to register a security interest in types of property which are negotiable or semi-negotiable on the assumption that the transferee of such property would not think to look to the registry. The one exception to this general principle as contained in Canadian models is that a security interest in any type of property covered by a floating charge can be registered. However, in the Saskatchewan Act, specific protection is given to anyone who acquires an interest in this type of property even though the prior security interest has been perfected by registration. See section 30(6). I do not see any equivalent to this in the India Act. I realise that the purchaser of a negotiable instrument is protected under the India Act but that protection only arises if the instrument is acquired under circumstances which would amount to negotiation under Bills of Exchange law (section 36). I do not want to leave the

impression that the concept of registration for a much broader range of collateral is a bad idea. Indeed, the Canadian Bar Committee is still considering the possibility of allowing registration for every type of collateral with the appropriate safeguard for bona fide purchasers.

I note that section 30 of the India Act is patterned substantially after the 1962 version of Article 9-312 of the Uniform Commercial Code and section 35 of the Canadian Bar Model Act. In the 1972 version of Article 9-312 of the Uniform Commercial Code the priority rules were simplified so as to avoid confusion which had developed in the application of the older version. The Saskatchewan Act adopts the 1972 version of the Uniform Commercial Code priority rules.

The Saskatchewan and India Acts differ in many other minor ways. However, these differences will become apparent to you when you compare the two. If you would like clarification of any of the provisions contained in the Saskatchewan Act, please feel free to contact me.

I trust that my comments will be of some assistance to you."

(4) Mr. HADDON STOREY, Attorney-General of Victoria, 221, Queen Street, Melbourne, Victoria, Australia (vide his letter dated 8th September 1976 to the Secretary, Banking Laws Committee).

"I refer to my letter of 11th August 1976 in relation to the report of your Committee on Personal Property Security Law.

I have had the report examined, and it is noted that the Committee has not found it practicable to implement a registration scheme, but has made the maximum use of existing registration procedures relating, for example, to motor vehicles. In this regard I draw your attention to the compromise solution adopted in the Molomby Report (see chapter 5.14A), under which a bona fide purchaser for value and without notice of a prior security interest would, in general, displace the prior security and the holder of the prior security interest could be protected by insurance.

At present I am only able to add that your Committee's report accords closely with our approach. It may be possible at a later stage to make some more comments, when the working party has made further progress with its task."

(5) Mr. WALTER MALCOLM (through Mr. ROBERT HAYDOCK, Jr., Bingham, Dana & Gould, 100, Federal Street, Boston, Massachusetts, U.S.A. (vide Mr. Haydock's letter dated 3rd November 1976 to the Secretary, Banking Laws Committee).

"Walter Malcolm, to whom you addressed the project study on personal property security law has retired completely from the practice of law. I forwarded the study to him, however, and received from him some general comments about it which I pass along to you.

He is concerned about the fact that instead of establishing its own filing system for collateral covered by the law, the proposed act makes use of existing recordation statutes. Since we do not have copies of these laws, it is difficult to know to what extent their use will inhibit the flexibility written into the filing system of Article IX of the Uniform Commercial Code.

Section 9-402 of the Code is designed to permit "notice filing" in that it specifically permits describing the collateral by "type" and contemplates that the collateral described in that manner will not necessarily be covered by a security agreement. Notice filing is of particular significance in connection with trust receipt transactions. A single financing statement covering "wool" or "motor vehicles" will be sufficient to cover a whole series of subsequent trust receipts (security agreements) and yet will have no effect on particular wool or particular motor vehicles which the debtor finances elsewhere or does not finance at all.

In looking at the proposed amendments to the Registration Act, 1908, I see a requirement that the application must contain a description of the personal property "sufficient to identify it." This alone would seem to prevent notice filing in the trust receipt situation, since the parties at the beginning may not know which wool or which motor vehicles they plan to finance.

It may be that you have decided that notice filing will not play an important part in the commerce of India. There still remains in our minds, however, a concern that old statutes, such as the Registration Act, 1908, carry with them interpretations which are inconsistent with the spirit of the new personal property security act. It may be, for example, that there are cases under the old acts which indicate that a description does not sufficiently identify property unless it gives the make and serial number. Such a requirement, of course, would seriously interfere with the attempt to validate security interests in property to be acquired in the future and in the proceeds of such property.

We hope that these very general comments will be of some help to you and wish you great success in going forward with the project. It demonstrates careful and thoughtful work.

With best wishes."

(6A) Mr. R. J. Ellicott, Attorney-General of Australia, Canberra (vide his letter dated 31st August 1976 to the Secretary, Banking Laws Committee).

"I was very pleased to hear from you again and to receive a copy of the Banking Committee's Report.

I can appreciate that the preparation of legislation in this field has been a very formidable task. I have asked my Department to continue its assistance and provide the Committee with comments on the Report.

In recent correspondence you asked my Department for copies of draft Bills based upon the Molomby Reports when they become available. I would hope to be able to send you copies of the draft Bills in the near future.

With kind regards,"

(6B) The Attorney-General, Canberra, Australia (vide letter dated 10th December 1976 to the Secretary, Banking Laws Committee).

"I refer to the Attorney-General's letter of 31 August 1976 in which he mentioned that he had asked the Department to provide your Committee with comments on its Report on Personal Property Security Law.

Your Report has been of great interest to officers in the Department working on the subject of consumer credit. It is particularly timely as the Department is presently participating in the work of the Credit Laws Committee set up by the Standing Committee of Commonwealth and State Attorneys-General. The Committee is to study the Molomby Report on Fair Consumer Credit Laws, draft Bills giving effect to the recommendations of the Molomby Report and to assist in settling the Bills as model uniform legislation for the Australian States and Territories. As you are no doubt aware, a significant section of the Molomby Report is devoted to Chattel Securities.

Because of different circumstances existing in Australia, the approach taken by the Molomby Committee does not correspond with the approach taken in your Report. The reasons for the differing approach taken by your Committee are, however, understood.

The question of a registration system for chattel securities has been the subject of comment for some time in this country. Professor Peden in his article "Title Problems in Relation to Chattels—Proposals for a Registration System for Motor Vehicles in Australia" (1968 42 ALJ 230) first broached the issue. I enclose a copy of this article, in case it may be of assistance.

Because of doubts as to the costs of introducing a registration system of Chattels securities, the Molomby Committee in its Supplementary Report recommended abandonment of the search for a register and accepted the solution adopted in South Australia as practicable. The Molomby Committee commented: "If the holder of the security interest is protected by insurance at a cost less than the establishment and operation of a registration and search system such as we propose it is plain that it is possible to arrive at a fair and workable result".

The South Australian scheme involves three elements:

(a) the credit provider gets a charge by virtue of the execution of an instrument;

(b) the charge does not operate against a bona fide purchaser for value and without notice;

(c) insurance covers the credit provider against loss of charge.

The relevant legislative provision is Section 36 of the South Australian Consumer Transactions Act 1972-1973 which provides as follows:

> "36. (1) Subject to sub-section (2) of this section, where a person, in good faith and for valuable consideration, purports to acquire title to goods subject to a consumer lease, or consumer mortgage, without actual notice of the interest of the lessor or mortgagee in the goods, from the lessee or mortgagor or a person who is, with the consent of the lessee or mortgagor, in possession of the goods in circumstances in which he appears to be the owner of the goods, that person shall acquire a good title to the goods in defeasance of the interest of the lessor or mortgagee in those goods.
>
> (2) This section does not apply to the purported acquisition of title to goods by a person who carries on a trade or business in which he trades in goods of that description.

(3) In any proceedings the onus of proving that a person has acquired a good title to goods under sub-section (1) of this section shall lie on the person asserting that title."

It is my understanding that the South Australian scheme has been successful. Recently Judge White, Chairman of the South Australian Credit Tribunal in his Report "Fair Dealing with Consumers" recommended that Section 36 of the Consumer Transactions Act should be extended so as to include non-consumer credit contracts and leases, where the value of the goods is less than $10,000. He further recommended that the present ceiling of $10,000 should be increased to $15,000 and a formula be devised for annual adjustments of the ceiling figure. He also recommended that an inquiry should be held into actual losses resulting from Section 36 of the Consumer Transactions Act (due to consumer dishonesty) with a view to abolition of title insurance as a consumer expense. For further information as to the South Australian scheme, you could contact Mr. M. Noblet, Director of Public and Consumer Affairs, G.R.E. Building, 50, Grenfell Street, Adelaide, South Australia, 5000.

Article 9 of the Uniform Commercial Code is generally regarded as a sound base for reform of the law in this area. The Molomby Report was influenced by it. In view of the complexity in this area of law care needs to be taken in transplanting unfamiliar concepts. The approach that you have taken would seem to avoid this pitfall.

I note that your committee is to look at aspects of consumer credit at a later date. The Molomby Committee in its supplemental Report were impressed by a suggestion made by Professor Peden that there should be one Act covering Chattel Securities in general, and that special provisions to govern securities in the case of consumer credit transactions should be contained in another Act.

It is anticipated that the draft Bills based upon the Molomby Reports will be available early next year. I shall arrange for copies of the Bills to be forwarded at that time. I hope these comments will be of interest."

ANNEXURE 11

MEMORANDUM REGARDING THE IMPACT OF MONEY LENDING LEGISLATION ON BONA FIDE COMMERCIAL AND TRADE TRANSACTIONS

"President

THE BOMBAY SHROFFS ASSOCIATION
BOMBAY

233-A, SHROFF BAZAR,
BOMBAY 400 002.

Date : 11-10-1977.

Ref. No. S/190/A/2033

The Chairman

Banking Laws Committee
"White House"
91, Walkeshwar Road
BOMBAY 400 006.

Dear Sir,

Review of the laws relating to unsecured advances—Review of moneylending legislation

The Banking Laws Committee has been entrusted *inter alia* with the task of reviewing the laws relating to unsecured advances. In this review of the laws relating to unsecured advances, prime attention may have to be given to the moneylending legislation in force in the different States of our country. Hence, we presume that the Banking Laws Committee would *inter alia* be reviewing this legislation also and would make appropriate recommendations.

2. In the above context, we enclose a copy of our Memorandum submitted to the Government of Maharashtra regarding the impact of the moneylending legislation on bona fide commercial and trade transactions. From our submissions in the Memorandum it may be seen that the moneylending legislation in our country requires to be replaced by an adequate consumer credit legislation. Though the submission in the Memorandum have particular reference to the legislation in force in the State of Maharashtra, we understand that many of the features attributable to this legislation are common to the legislation in force in other States as well.

3. From the Report of the Project Study on Personal Property Security Law, sponsored by the Banking Laws Committee and circulated for comments to several Chambers of Commerce, we understand that the Project Study was originally planned to cover also the special aspects of consumer credit. Except as regards some changes to the scope of the Hire-Purchase Act, 1972, this Study has not covered the features of consumer credit legislation.

4. Since several features of the moneylending legislation in force in the different States have an adverse impact on bona fide commercial and trade

transactions and this is neither appropriate nor could have been the objective of the legislation, we submit that the Banking Laws Committee may also kindly take up the review of our moneylending legislation and make appropriate recommendations to the Central and State Governments in order that the undesirable features in the moneylending legislation, particularly in so far as they apply to business credit, may be eliminated. We shall be grateful if this work could be taken up urgently.

Thanking you.

Yours faithfully,

(Sd.)

PRAVINCHANDRA V. GANDHI,
President.

Enclosure No. 1

Memorandum Regarding the Impact of The Moneylending Legislation on Bona Fide *Commercial and Trade Transactions*

We submit for the consideration of the Government of Maharashtra the undesirable adverse impact on bona fide commercial and trade transactions consequent on the application of the provisions of the Bombay Moneylenders Act, 1946, and particularly by the Amendment Acts of 1975 and 1977 to cover credit transactions between members of the business community.

2. *Obsolete Scheme*

Before setting out in brief how the present scheme of moneylending legislation in Maharashtra adversely affects the flow of business and the cost of credit to the genuine needs of trade and commerce, we would like to bring to the notice of the Government that the present scheme of moneylending legislation in our country, not merely in Maharashtra but in other States also, has become anachronistic, antiquated and outmoded.

3. *Given up in Other Countries*

The moneylending legislation in all the States of our country was originally based on the corresponding legislation which prevailed in the United Kingdom. Protection to indigent rural and agricultural borrowers has been the aim of this legislation, that is, as a measure of *Consumer Credit Protection.* However, subsequent research and studies have clearly demonstrated the futility of the scheme as a measure of consumer credit protection. Based on the recommendations of the Crowther Committee, which was constituted in the United Kingdom to review the law relating to consumer credit, the moneylending legislation in that country has now been scrapped, yielding place to the Consumer Credit Act, 1974. Not merely in the U. K. but also in the States of Australia, in the States of the U. S. A., in the States of Canada and in other countries the recognition of such inadequacies had led to comparable developments which have replaced the outmoded scheme of moneylending legislation of the respective countries and their replacement by modernised versions meant to serve as consumer credit protection measures segregating same from business credit.

4. *Needs to be Replaced in Our Country as Well*

Our schemes of moneylending legislation in force in the different States of our country suffer from the same basic inadequacies and deficiencies which led to the repeal of the moneylending legislation in the United Kingdom and other countries and its replacement by an adequate Consumer Credit Act. Realising this, high-powered authorities, like the Banking Commission's Study Group which reviewed legislation affecting banking (1971) and the Banking Commission (1972), have stressed the need for and recommended a review of the laws governing moneylending (*vide* paragraph 8.3 of the Study Group's Report and paragraph 21.34 of the Banking Commission's Report).

5. *Impractical Situation Re. Business Credit*

Thus, the basic scheme of moneylending legislation in force in the States of our country has to be subjected to a comprehensive review. Pending this, we would like to draw the Government's attention to the resulting impractical situation due to the application of the present moneylending legislation in the State of Maharashtra to cover credit transactions between traders and members of the business community. The consequent fundamental deficiencies that are touched here in brief point the immediate necessity for excluding the business credit from the scope of the moneylending legislation.

6. *Deposit-Taking Beyond the Concept of Moneylending*

The Moneylending legislation in Maharashtra, purports to cover also the making of deposit with proprietary or partnership business concerns (*vide* clarification from the Officer on Special Duty Agriculture and Co-operation Department, Government of Maharashtra, by his letter No. MLA. 1477/1965/2-C, dated the 9th May 1977 addressed to the Indian Merchants' Chamber, Bombay, and letter of even No. dated 22nd April 1977 addressed to us). Making of deposits falls outside the concept of moneylending. The Banking Commission's Study Group which reviewed legislation affecting banking (paragraph 2.17 of its Report) and the Banking Commission (paragraphs 19.3 and 19.17 of its Report) have clearly brought out the fact that acceptance of deposits, irrespective of the purpose for which they are accepted, is a form of banking function. This is so whether the person accepting the deposits is a corporate body, a private firm or an individual. Hence, it is obvious that the persons who make deposit with such private firms cannot be regarded as moneylenders. Thus, so far as the moneylending legislation purports to cover also the making of deposits, it is trenching on the field of "banking" and the legislation would require to be suitably modified.

7. *Requirements not related to regulation*

The requirements to be complied with under the legislation in so far as it seeks to cover trader's credit, are not related to the requirments of the regulation. For instance, the authorities are required to be furnished with duplicate sets of accounts pertaining to *all* the transactions of a "moneylender" that may have taken place during the year. In so far as business credit is concerned no useful statistical or regulatory purpose is served by such returns which are not really necessary and which inflate the cost of credit and the overhead expenses.

8. *In Practice, it is Prohibition, not mere Regulation*

So far we have set out some of the basic conceptual objections for the scheme of moneylending legislation. Now we would like to draw Government's attention also to the severe practical restrictions which, in their cumula-

tive effect, have a crippling effect on business transaction when the full scope and magnitude of the legislative provisions are envisaged.

9. *No Value for Settled Accounts*

That the moneylending legislation's application to business transactions upsets commercial certainty is further made clear by the provisions in the legislation which provide for no finality at any time for the settlement of the accounts between the "moneylender" and the "debtor". The debtor is not bound to acknowledge or deny the correctness of the statement of account required to be furnished to him; what is the purpose of giving him the statement of account? The court is bound to "reopen any transaction, or any account already taken between the parties". Thus, there would be no finality to business transactions for the accounting year, even years after closing of the books of accounts of the businessman.

10. *Damdupatt Rule and Reopening of Accounts*

The cumulative effect of the application of the Damdupatt rule and rule prohibiting payment of compound interest, when considered with the position that there is no finality for settled accounts, highlights the fact that business credit cannot be subjected to these terms.

11. *Adverse Impact on Available Business Resources*

When the Government wants to increase the allocation of credit to the small business people, it may be appreciated that the cumulative effect of the provision of the moneylending legislation will be highly pernicious resulting in virtually prohibiting and not merely regulating the provision of business credit by "moneylenders". This is due to the misapplication of scheme meant to protect village agriculturists and rural artisans to the members of a business community. It is widely felt that the objective of the Government to protect the weaker sections of the society will be better served if loans and deposits to persons having Permanent Account Number and/or General Index Register Number (popularly known as G. I. R. Number) under the Incometax Act is excluded for the purpose of Moneylenders Act.

12. *Disincentive for Prompt Repayment*

The prohibition in the legislation against charging a penal rate of interest for any default committed by the debtor in the payment of the sums on the due dates is a disincentive for prompt repayment of credit on the due dates, which is basic for business sustenance.

13. *Bars Bank-credit against Account Receivables*

Businessmen offer as security their account receivable to commercial banks and the need for measures to facilitate such credit is now recognised. But, the provisions of the moneylending legislation which require that the businessman should advise the assignee of the account receivable that the debt is subject to the requirements of the moneylending legislation and that the banker will stand in the shoes of the moneylender in so far as his rights relating to the recovery of the assigned debt, would effectively ensure that as against such account receivables *no bank finance* is forthcoming. Again, we would submit that this result arises by reason of the application of a scheme meant for a totally different context to govern also business credits.

14. *Serious consequences for mere Technical Flaws*

It is possible that over the course of years when dealing with numerous transactions, with reference to any one of them a moneylender may be considered as technically contravening any of the provisions of the Act. But the consequences are so grave that they bear no relation to the fact as to whether the contravention of the Act or the Rule or the term of the licence is a mere technicality or a major irregularity. In all cases, the debt is made irrecoverable. The security pledged has to be returned and will not be available for realisation of the debt. As regards any omission which might be due to some clerical lapse in the office of a businessman in the submission of the returns to be furnished by him to the Assistant Registrar, the consequence is fraught with grave danger which may result in the disallowance of the interest.

15. One aspect to be seen is that such penal consequences arise on the basis of the opinion the courts may entertain. Even a well considered counsel's opinion, on which a businessman may base his business practices concerning the matters dealt with by the moneylending legislation, may not protect him as courts may view the matter differently. This may happen years after the transaction is entered into.

16. *Unnecessary Limits to Summary Proceedings.*

While the legislation provides a summary remedy for the debtor to approach the court for determination of the amount due, there is no reason why this remedy should be denied to the "moneylender" when the debtor raises any dispute as regards the amount due. Now he is forced to file a regular suit which involves additional cost, a portion of which at least is ultimately recoverable from the debtor and adds to his burden.

17. *Prayers*

Under the circumstances, we respectfully submit that the Government may favourably consider the aforesaid aspects and

(1) may please take up urgently the question of the replacement of our moneylending legislation by an appropriate, modernised and beneficial consumer credit legislation in line with the development in this regard in other countries segregating same from business credit;

(2) may please take up urgently the modifications to the present scheme of moneylending legislation in order to give urgent relief to the business community, pending the replacement of our moneylending legislation by a consumer credit legislation and in this context consider exclusion of the application of the moneylending legislation :

(i) to the members of the business community and with reference to transactions between traders, including the members of the indigenous banking community;

(ii) to transactions which are in the nature of 'deposit-making', and

(iii) to credit transactions where consideration is received in kind; and

(iv) loans and deposits to persons having permanent account number and/or General Index number under the Income tax Act.

(Sd.)

PRAVINCHANDRA V. GANDHI,
President.

ANNEXURE 12

SHRI R. KRISHNAN

SECRETARY

BANKING LAWS COMMITTEE

(Government of India)

(Deputy Legal Adviser, R.B.I.)

OTHER OFFICIALS OF THE SPECIAL CELL ASSISTING THE BANKING LAWS COMMITTEE

Shri	L. H. Kulkarni	Banking Officer
,,	S. B. Fos	do
,,	N. K. Puri	Legal Officer
,,	D. R. Sardesai*	Rural Credit Officer
,,	Ch. L. Mohana Rao	Sub-Accounts Officer
,,	O. S. Khanna	do
,,	A. F. Pereira	do
,,	A. R. Dalvi	do
,,	V. Vembu	Personal Assistant

*Earlier associated with the work of the Committee.

TABLE OF CASES

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Tagore *vs.* Tagore, (1872) 9 Beng. L.R. 37; I.A. Supl. Vol. 47	1.2.38
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107	2.2.1	1	Production oriented,	Production-oriented,
112	2.2.15	21	different companies."[1]	different companies."[8]
123	2.2.52	1	2.2.50. When the above points are taken care of, the expected conflict	2.2.52 Section 45 of the draft Bill prepared by the project team
154	2.7.1	2	able claim and its assignment by way of security is so blurred that	able to the parties to a security agreement, we have to have regard
186	(85)	1	interests	interest
190	(93)	5	of undoubted integrity and credit-worthiness. (2.4.1)	of the person havin an interest in the fixture. (2.3.12)
198	(122)	12	for ascertain	for ascertaining
240	—	30	cohrt	Court.
244	—	22	(b) and (c)	(b) and (d)
250	—	31	1971	197 -

(1)	(2)	(3)	(4)	(5)
251		18	Amend ments.	Amendment
252	—	22	entered on.	entered in.
255	—	28	capacity	capacity;
262	—		assgnees.	assignees.
291	—	9	Trust receipts	Trust receipt.
314	—	17	16.25.1	17.1.1.
314	—	17	thase questions	this question
317	Annexure 6-Heading	1	QUESTION, NAIRE	QUESTIONNAIRE
348	42(2)	1	Subjet	Subject
355	6 (1)(a)	1	statment	statement
363	Schedule IV	1	transfer of property act,	Transfer of Property Act,
367	Sr. No. 79	1	Trade.	Trade
368	Annexure 9 Sr. No. 19	1	Finance	Financial
368	Annexure 9 Sr. No. 35	1	Department of Canberra.	Department, Canberra,
381	Para 2	6	submission	submissions
384	11	3	provision	provisions
385	17	5	development	developments
390	—	24	Distribution	Distinction
391	—	21	Chattle	Chattel
393	—	4	effect of disposition notice	effect of dispcsitic n
395	—	38	FN. 1.3.57	FN 1.3.74, 1.4.71
400	—	5	1.4.58	1.4.59
402	—	25	insolvency	insolvency
402	—	26	enforcibility	enforceability
402	—	30	s. 45 5	s. 45 S
403	—	13	2.6.8,	2.6.18,

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