2022 INSC 562

REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 5443 OF 2019

PTC INDIA FINANCIAL SERVICES LIMITED ..... APPELLANT

VERSUS

VENKATESWARLU KARI AND ANOTHER ..... RESPONDENTS

J U D G M E N T

SANJIV KHANNA, J.

The primary legal issue which arises for consideration in this appeal is whether the Depositories Act, 1996 read with the Regulation 58 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996[1] has the legal effect of overwriting the provisions relating to the contracts of pledge under the Indian Contract Act, 1872[2] and the common law as applicable in India. To facilitate analysis, this judgment has been divided into sections as follows:

1 For short, '1996 Regulations'.
2 For short, 'Contract Act'.

A. Factual background of the case

B. Relevant provisions of the Contract Act

C. Analysis of case laws under the Contract Act:

(i) *What is pledge and the legal difference between ownership, pledge and mortgage*

(ii) *Pawnee has a special and not general right in the pledged property*

(iii) *Accretion on pawned goods*

(iv) *Notice of sale by pawnor and his right to sale*

(v) *Sale of the pledged goods by the pawnee to self*

D. Effect and Purpose of the Depositories Act, 1996 and the Securities and Exchange Board of India (Depositories and Participants) Regulation 1996

E. Effect of the Depositories Act, 1996 and the Securities and Exchange Board of India (Depositories and Participants) Regulation, 1996 on the pledge under the Contract Act, 1872

F. Four decisions

G. Analysis of facts and application of law of pledge to the facts of this case

H. Conclusion

A. <u>Factual background of the case</u>

2.1 The appellant – PTC India Financial Services Limited,[3] is an existing company under the Companies Act, 2013. It is a wholly-owned subsidiary of PTC India Limited, which in 1999 was promoted by four public sector undertakings, namely, NTPC Limited, Power Finance Corporation Limited, NHPC Limited, and

3 Hereinafter referred to as "PIFSL".

Power Grid Corporation of India Limited. PIFSL is registered with the Reserve Bank of India[4] as a Non-Banking Finance Company[5] and classified as an Infrastructure Finance Company.[6] The principal business of PIFSL is to invest in power and energy sector projects in India.

2.2 PIFSL, by way of a Bridge Loan Agreement dated 10th March 2014, had advanced a loan of Rs. 125 crores to NSL Nagapatnam Power and Infratech Limited.[7] As per Clause 3.1.1 of the Bridge Loan Agreement, the loan is required to be secured. In accordance with sub-clause (6) of Clause 3.1.1, on 10th March 2014 thereof, the second respondent, Mandava Holdings Private Limited,[8] executed a Pledge Deed in favour of PIFSL, thereby, pledging 31,80,678 shares, equivalent to 26% of the shares of NSL Energy Ventures Private Limited.[9] NNPIL and NEVPL are subsidiaries of MHPL.

2.3 On 17th November 2017, the Corporate Debtor filed a petition invoking Section 10 of the Insolvency and Bankruptcy Code, 2016[10] before the National Company Law Tribunal, Hyderabad,[11]

4 Hereinafter referred to as “RBI”.
5 Hereinafter referred to as “NBFC”.
6 Hereinafter referred to as “IFC”.
7 Hereinafter referred to as “NNPIL” or “Corporate Debtor”.
8 Hereinafter referred to as “MHPL”.
9 Hereinafter referred to as “NEVPL”.
10 For short, ‘IBC’.
11 Hereinafter referred to as “Adjudicating Authority”.

initiating the corporate insolvency resolution process. The petition was admitted under Section 10(4) of the IBC on 18th January 2018. Mr. Venkateswarlu Kari, respondent No. 1, was appointed as the Interim Resolution Professional.[12]

2.4 On 28th December 2017, PIFSL issued a notice under the Pledge Deed apprising MHPL on the defaults on the part of Corporate Debtor and that if the debt due was not discharged within seven days, PIFSL would exercise the rights in terms of the Pledge Deed.

2.5 On 16th January 2018, as the debt remained unpaid, PIFSL wrote to the Depository Participant invoking its rights in terms of Clause 6.1 of the Pledge Deed. Acting on the request, the Depository Participant has accorded PIFSL the status of 'beneficial owner' of 31,80,678 pledged shares of NEVPL.

2.6 On 23rd January 2018, PIFSL wrote to MHPL informing that due to continued defaults in payment on the part of the Corporate Debtor, it had exercised the right under Clause 6.1, while reserving its right to sell the shares under Clause 6.2 of the Pledge Deed read with Section 176 of the Contract Act.

12 Hereinafter referred to as "IRP".

2.7 On 17th January 2018, PIFSL filed an application before the Adjudicating Authority under Section 7 of the IBC as a financial creditor to whom Rs. 167,29,23,507/- was due and payable by the Corporate Debtor.

2.8 On 30th January 2018, the Adjudicating Authority allowed PIFSL to withdraw the application with liberty to file proof of financial claim before the IRP in Form C.

2.9 On 6th February 2018, MHPL made a claim before the IRP, *inter alia*, stating that PIFSL having been conferred status of 'beneficial owner', MHPL no longer has any title or right over 31,80,678 shares. Accordingly, MHPL had stepped into the shoes of PIFSL as a creditor of the Corporate Debtor to the extent of the value of 31,80,678 shares of NEVPL now owned by PIFSL.

2.10 Contrarily, on 10th February 2018, PIFSL submitted Form C with a financial claim of Rs.169,19,17,637/-, being the amount due and payable to PIFSL by the Corporate Debtor as of 18th January 2018, the date on which the Adjudicating Authority admitted the Section 10 application of the Corporate Debtor. The value of 31,80,678 pledged shares was not accounted for or reduced.

2.11 On 19th February 2018, the IRP, by two separate emails, informed that MHPL's claim could not be crystalized as it was not possible to ascertain the value of 31,80,678 shares 'transferred' to PIFSL. Similarly, PIFSL's claim cannot be crystalized due to the settlement in whole/part of its claim and the need to arrive at the valuation at the time of 'transfer' of shares to PIFSL.

2.12 PIFSL and MHPL preferred separate applications before the Adjudicatory Authority against the rejections of their claims.

2.13 By a common order dated 6th July 2018, the Adjudicating Authority disposed of the applications filed by PIFSL and MHPL, accepting the MHPL's claim by primarily relying on the Depositories Act and Regulation 58 of the 1996 Regulations. The Adjudicating Authority agreed with MHPL that PIFSL having exercised its right under the Pledge Deed to 'transfer' 31,80,678 pledged shares, MHPL's shareholding in NEVPL got reduced by 31,80,678 shares. Therefore, MHPL is a financial creditor of the Corporate Debtor to the extent of the value of 31,80,678 shares. Further, 16th January 2018, the date on which the pledge was invoked by PIFSL, is the crucial date for determining the extent to which PIFSL and MHPL are the financial creditors of the Corporate Debtor. The IRP was directed to appoint an independent valuer to assess the fair

market value of 31,80,678 shares of NEVPL as on 16th January 2018.

2.14 PIFSL challenged the orders before the National Company Law Appellate Tribunal, New Delhi,[13] but the appeals were dismissed *vide* the impugned judgment dated 20th June 2019. The Appellate Authority has held that PIFSL had exercised its rights under Clause 6.1 of the Pledge Deed on 16th January 2018 and consequently, the pledged shares stood transferred in the name of PIFSL. The fact that PIFSL had not thereafter sold the shares under Clause 6.2 of the pledge deed would not matter. As PIFSL had become the 100% owner of the pledged shares, it could realize its dues in whole or part by sale and transfer of the shares according to the law. Once PIFSL has exercised right to become the owner of the shares, PIFSL cannot take advantage of Section 176 of the Contract Act to 'reclaim' the debt. Section 176 of the Contract Act cannot be taken into consideration by the IRP for collating the financial claim of PIFSL under Section 18 of the IBC.

2.15 Other aspects which require to be noted are: (a) as per PIFSL, the principal and interest amount due to them by the Corporate Debtor as of 23rd December 2021 are Rs.3,76,13,03,389/-; (b) the shares of NEVPL are unlisted, and there are no open market

13 Hereinafter referred to as 'Appellate Authority'.

transactions, and (c) the value of the pledged shares is disputed. On 13th August 2018, the IRP has submitted a valuation report of an independent valuer who has valued the pledged shares at Rs.179 crores as of 16th January 2018. MHPL relies on the 2013 valuation report of Axis Capital and the annual report of MHPL for the financial year 2012-13. As per the annual report relied on by MHPL, shares of NEVPL as of 31st March 2013 were valued at Rs.1229.66 crores. Accordingly, MHPL claims that the fair value of each of the 1,22,33,378 shares of NEVPL (100% of the total equity shares – all held by MHPL) was Rs.1,005.17p per share. Therefore, the total value of the 31,80,678 pledged shares was equivalent to Rs. 319 crores at the time of the creation of the pledge. On the other hand, PIFSL claims that the actual value per share of NEVPL, as calculated on 31st March 2016, is only Rs. 58.97. Thus, the total value of pledged shares comes to only Rs.18,75,64,582/-.[14]

B. Relevant provisions of the Contract Act

3.1 Chapter IX of the Contract Act deals with 'Contracts of Bailment'. Sections 148 to 171 lay down the general law pertaining to

14 There are different recognised and established methods for valuation of unlisted securities – See, (i) *Commissioner of Wealth Tax* v. *Mahadeo Jalan and Mahabir Prasad Jalan and Others Etc.*, (1973) 3 SCC 157; and (ii) *Bharat Hari Singhania and Others* v. *Commissioner of Wealth Tax (Central) and Others*, 1994 Supp. (3) SCC 46.

bailments, while Sections 172 to 179 delineate specific provisions concerning pledges, which are a subset of bailments.

3.2 As per Section 151, a bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his goods of the same bulk, quality and value as the goods bailed. Section 152 states that a bailee, in the absence of a special contract, will not be liable for any loss, destruction, or deterioration of the bailed goods if he acts in conformity with Section 151. As per Section 153, a contract for bailment is voidable at the option of the bailor if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment. Section 154 lays down that the bailee shall be liable for damage arising from unauthorized use of the bailed goods. The bailee, with the consent of the bailor, can mix the goods bailed with his own goods, in which event, the bailor and the bailee will have interest in proportion to their respective shares in the mixture.[15] However, if the bailee, without the bailor's consent, mixes the bailed goods with his own, and the goods can be separated or divided, the property in the goods remain with the parties respectively.[16] Further, the bailee is bound to bear the expense of separation or division of the goods, as well as any

15 Section 155, Contract Act.
16 Section 156, Contract Act.

damage arising from the mixture. Section 157 provides that when the goods are so mixed without the bailor's consent and cannot be separated, the bailor is liable to be compensated, and the bailee is liable for the loss. Under Section 160, the bailee has to return or deliver, as per the bailor's directions, the goods, without demand, as soon as the time for which they were bailed has expired or the purpose for which they were bailed has been accomplished. Section 161 states that if there is a default by the bailee and the goods are not returned, delivered, or tendered at the proper time, the bailee is responsible to the bailor for any loss, destruction, or deterioration of the goods from that time. As per Section 163, in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or in accordance with his directions, any increase or profit that may accrue from the goods bailed.

3.3 Section 172 of the Contract Act is reproduced as under:

> "**172. 'Pledge', 'pawnor' and 'pawnee' defined –** The bailment of goods as security for payment of a debt or the performance of the promise, is called a 'pledge'. The bailor is in this case called the 'pawnor'. The bailee is called 'pawnee'".

As per Section 172, creating a valid pledge requires delivery of the possession of goods by the pawnor to the pawnee by way of security upon the promise of repayment of a debt or the

performance of a promise, thereby, creating an estate that vests with the pawnee.

3.4 Sections 176, 177 and 179 of the Contract Act read thus:

> "**176. Pawnee's right where pawnor makes default. —** If the pawnor makes default in payment of the debt, or performance; at the stipulated time or the promise, in respect of which the goods were pledged, the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale.
>
> If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor."
>
> xx xx xx
>
> **177. Defaulting pawnor's right to redeem. –** If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them, but he must, in that case, pay, in addition, any expenses which have arisen from his default."
>
> xx xx xx
>
> **179. Pledge where pawnor has only limited interest.–** Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest."

As per Section 176, when a pawnor makes a default in payment of debt or performance of a promise, the pawnee may bring a suit against the pawnor upon such debt or promise and retain the goods pledged as collateral security, or he may sell the

goods pledged upon giving the pawnor reasonable notice of the sale. If the pledged goods are sold, and the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance amount to the pawnee. If the proceeds of such sale exceed the amount due, the pawnee will be liable to pay the surplus to the pawnor.

Section 177 gives statutory right to the pawnor, who is at default in payment of the debt or performance of the promise, to redeem the pledged goods at any time before 'actual sale' by the pawnee. However, in such cases, the pawnor must pay in addition the expenses that have arisen from his default.

Section 179 states that the limited interest that a pawnor has in the goods can be validly pledged.

Having understood the broad statutory contours of pledge, we would now examine the relevant *opinio juris* on the law of pledge. Legal jurisprudence relating to law of pledge is required to be examined in some detail for determining the issue before us.

C. Analysis of law of pledge and case laws relating to pledge

(i) What is pledge and the legal difference between ownership, pledge and mortgage.

4.1 ***Md. Sultan and Others*** v. ***Firm of Rampratap Kannayalal, Hyderabad, by its partners***[17] observes that a contract of pledge should satisfy the following conditions:

(i) there should be a bailment of goods as defined in Section 148 of the Contract Act, that is, delivery of goods;

(ii) the bailment must be by way of security; and

(iii) the security must be for payment of debt or performance of a promise.

The decisions in ***Md. Sultan*** (supra) and ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu (died) and others*** v. ***The Andhra Bank Ltd. Vijayawada and others***[18] observe that hypothecation and mortgage of movables, though not specifically mentioned in the Contract Act, are valid and enforceable in India as the Contract Act is not an exhaustive law on the subject. Such transactions beyond the statutory framework are given effect to and interpreted by the courts according to the principles of justice, equity, and good conscience. There is no standard format and incidents in a contract of pledge can be different. A term mutually agreed by the parties is valid as long as it is not contrary to or inconsistent with any provision of the Contract Act. In the context of the present

17 AIR 1964 AP 201.
18 AIR 1960 AP 273.

case, the aforesaid principles relating to the law of pledge reflecting flexibility are important in the milieu of a transitional and commercial environment wherein significant changes have occurred across the capital market with *inter alia* advent of institutional investors, regulatory mechanisms, and the new insolvency regime, *albeit* the fundamentals of the law of pledge, except when permitted or required to be eschewed, should be applied. This is the principle of interpretation which we have applied to answer the conundrum.

4.2 These two decisions highlight distinction between a pledge, which creates an estate or a right that vests with the pawnee, and a wider and general right of an owner; as well as mortgage or hypothecation.[19] An owner has: (a) right of possession; (b) right of enjoyment; and (c) the right of disposition. A pawnee does not have the right of ownership, but has limited right to retain possession till debt is paid or promise is performed. A pawnee's right of disposition is limited to disposition of the pledge rights

19 In the context of the present case, we need not examine the difference between pledge and hypothecation. It is sufficient to note that in hypothecation possession does not transfer and remains with the debtor. Hypothecation has been defined as a right which a creditor has over a thing belonging to another, and which consists in the power to cause it to be sold in order to be paid his claims out of the proceeds. It is an act of pledging a thing as security for a debt or demand without parting with the possession. It follows as a consequence that although the property remains in the possession of the debtor, it cannot be transferred to a third party without the express consent or permission of the creditor (*See, Simla Banking and Industrial Co., Ltd., Simla (In Liquidation)* v. *Pritams,* AIR 1960 Punj 42*)*. In India, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 defines it under Section 2(1)(n) as a charge in or upon any movable property, existing or future, created by a borrower in favour of a secured creditor without delivery of possession of the movable property to such creditor, as a security for financial assistance and includes floating charge and crystallisation of such charge into fixed charge on movable property.

only, and the right to sell after reasonable notice. Even when the pawnor makes default in payment of debt or performance of the promise, the pawnor has the right to redeem the pawn till ‘actual sale’ of the pawn by the pawnee. However, the pawnor in addition to the debt, must pay to the pawnee expenses that have arisen because of the default.

4.3 Where money is advanced by way of the loan upon the security of goods, the transaction may take the form of a mortgage or pledge. The difference between a pledge and a mortgage of movable property is that while under a pledge there is only a bailment, whereas under a mortgage there is transfer of the right of the property by way of security. The distinction is aptly brought out in the following passage in *Halsbury's Laws of England:*[20]

> “A mortgage of personal chattels is essentially different from a pledge or pawn under which money is advanced upon the security of chattels delivered into the possession of the lender, such delivery of possession being an essential element of the transaction. A mortgage conveys the whole legal interest in the chattels; a pledge or pawn conveys only a special property, leaving the general property in the pledger or pawnor; the pledgee or pawnee never has the absolute ownership of the goods, but has a special property in them coupled with a power of selling and transferring them to a purchaser on default of payment at the stipulated time, if any, or at a reasonable time after demand and non-payment if no time for payment is agreed upon.”

20 Hailsham Edn., (2nd Edn.), para 330, page 226 of Volume XXIII.

Therefore, unlike a pledgee, a mortgagee acquires general rights in the things mortgaged subject to the right of redemption of a mortgagor. In other words, the legal estate in the goods mortgaged passes on to the mortgagee. In comparison, a pawnee has only the special right in the goods pledged, namely, the right of possession as security and in case of default, he can bring a suit against the pawnor as well as sell the goods after giving a reasonable notice.[21] Whether a particular transaction is a mortgage of moveable property or a pledge can only be determined by reference to the intention of the parties, and other surrounding circumstances.[22]

(ii) <u>Pawnee has a special and not general right in the pledged property.</u>

5.1 This Court, in ***Lallan Prasad*** v. ***Rahmat Ali and Another***,[23] observes that under the common law, a pledge is a bailment of personal property as security for payment of debt or engagement. The two essential ingredients of pledge are (i) the pawn i.e., the property pledged should be actually or constructively delivered to the pawnee[24] and (ii) a pawnee has only special property in the

21 Para 20, *Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu* (supra)
22 *Arjun Prasad and others* v. *Central Bank of India, Ltd.*, 1954 SCC OnLine Pat 138.
23 AIR 1967 SC 1322.
24 See also *Morvi Mercantile Bank Ltd.* v. *Union of India*, AIR 1965 SC 1954: "20. In English Law a pledge arises when goods are delivered by one person called the 'pledgor' to another person called the 'pledge' to be held as security for the payment of a debt or for discharge of some other obligation upon the express or implied understanding that the subject-matter of the pledge is to be restored to the pledger as soon as the debt or other obligation is discharged. It is essential for the creation of a pledge that there should be a delivery of the goods comprised therein. In other words, a pledge

pledge but the general property therein remains in the pawnor and wholly reverts to him on discharge of the debt. The right to property vests in the pawnee only as far as is necessary to secure the debt. A pawn or pledge is an intermediate between a simple lien and a mortgage, which wholly passes the property. A pawnor has an absolute right to redeem the pledged property upon tendering the amount advanced but that right would be lost if the pawnee in the meantime has lawfully sold the pledged property. If the pawnee sells, he must appropriate the proceeds of the sale towards the pawnor's debt, for the sale proceeds are the pawnor's monies to be so applied and the pawnee must pay the pawnor any surplus after satisfying the debt.

5.2 Accordingly, the judgment refers to Section 172, which states that a pledge is a contract for bailment of goods as security for

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cannot be created except by delivery of the possession of the thing pledged, either actual or constructive. It involved a bailment. If the pledger had actual goods in his physical possession, he could effect the pledge by actual delivery; but in other cases he could give possession by some symbolic act, such as handing over the key of the store in which they were. If, however, the goods were in the actual physical possession of a third person, who held for the bailor so that in law his possession was that of the bailor, this pledge could be effected by a change of the character of the possession of the third party, that is by an order to him from the pledgor to hold for the pledgee, the change being perfected by the third party attorning to the pledgee, thus acknowledging that he thereupon held for the latter. There was thus a change of possession and a constructive delivery: the goods in the hands of the third party came by this process constructively in the possession of the pledgee. But where goods were represented by documents the transfer of the documents did not change the possession of the goods, save for one exception, unless the custodian (carrier, warehouseman or such) was notified of the transfer and agreed to hold in future as bailee for the pledgee. The one exception was the case of bills of lading, the transfer of which by the law merchant operated as a transfer of the possession of, as well as the property in, the goods. This exception has been explained on the ground that the goods being at sea the master could not be notified; the true explanation was perhaps that it was a rule of the law merchant, developed in order to facilitate mercantile transactions, whereas the process of pledging goods on land was regulated by the narrower rule of the common law." The quotation reflects flexibility.

payment of debt or performance of promise. Section 173[25] entitles the pawnee to retain the goods pledged for the payment of the debt. Section 176, elucidating on the rights of the pawnee, states that in case of default by the pawnor, the pawnee has: (a) a right to sue upon the debt and to retain the goods as collateral security, and (b) sell the goods after reasonable notice of the intended sale to the pawnor. Once the pawnee, by virtue of his right under Section 176, sells the goods, the right of the pawnor to redeem them is extinguished. But, thereupon, the pawnee is bound to apply the sale proceeds towards satisfaction of the debt and pay the surplus, if any, to the pawnor. So long as the sale does not occur, the pawnor is entitled to redeem the goods on payment of the debt. Even when the pawnee files a suit for recovery of the debt, though he is entitled to retain the goods, the pawnee must return the goods on payment. Another significant observation in this judgment is that if the pawnee sues on the debt denying the pledge, and it is found that he was given possession of the goods pledged and had retained the same, the pawnor has the right to redeem the pledged goods on payment of the debt. If the pawnee is not in a position to redeliver the goods, the pawnee cannot

25 173. Pawnee's right of retainer.—The pawnee may retain the goods pledged, not only for a payment of the debt or the performance of the promise, but for the interest of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

benefit from the repayment of the debt and the goods pledged. Where the value of the pawned goods is less than the debt and the pawnee denies the pledge or is otherwise not in a position to return the pawned goods, the pawnee has to give credit for the value of the goods and would be entitled only to recover the balance.

5.3 In ***Bank of Bihar*** v. ***The State of Bihar and Others***,[26] relying on the distinction between the right of ownership and the right of the pawnee under a pledge, this Court held that Section 173 of the Contract Act provides that the pawnee may retain the goods pledged only for payment of the debt, performance of the promise and also for interest on the debt, etc. The pawnee has a special property or interest in the thing pledged while the general property therein continues in the owner. The special interest exists in the pawnee so that the pawnee can compel payment of the debt or sell the goods when the right to do so arises. This special interest is distinguished from mere right of detention that the holder of lien possesses, since the pawnee may assign or pledge his special property or interest in the goods. Relying on Halsbury's Law of England, 3rd Edition, Vol. 29, page 222, it is observed that on the bankruptcy of the pawnor, the pawnee is a secured creditor with

26 (1972) 3 SCC 196.

respect to the things pledged before the date of receiving the order and without notice of a prior available act of bankruptcy.

5.4 In ***Maharashtra State Cooperative Bank Limited*** v. ***Assistant Provident Fund Commissioner and Others***,[27] a three Judges' Bench of this Court agreed with the ratio in ***Bank of Bihar*** (supra) and ***Lallan Prasad*** (supra) and proceeded to hold that in a contract of pledge, the property pledged should be actually or constructively delivered to the pawnee. The pawnee has only a 'special property' in the pledge, but the general property remains with the pawnor. The special property right in the pawned goods is higher than the mere right of detention of goods but lesser than the general property right. This means that the pawnee has the right to transfer the general property rights in the pawned goods if the pledge remains unredeemed. Reference in this regard was made to the decision of this Court in ***Karnataka Pawnbrokers' Association and Others*** v. ***State of Karnataka and Others***,[28] wherein it is observed that the pawnee has a conditional general property interest in the pledge, subject to the condition that he can pass on that general property if the pledge is brought to sale in accordance with the law.

27 (2009) 10 SCC 123.
28 (1998) 7 SCC 707.

(iii) Accretion on pawned goods

6.1 In ***Standard Chartered Bank and Another*** v. ***Custodian and Another***,[29] a Division Bench of this Court interpreting provisions of Sections 148, 160 and 172 of the Contract Act held that when the goods are bailed for securing payment of a debt or performance of a promise, the bailor will get the right for the return of the said goods when the purpose is accomplished, namely, the debt is returned, or the promise is performed. Referring to Section 163 of the Contract Act, it is observed that in the absence of a contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase of profit that may have accrued from the bailed goods. An example in this Section states that if a calf is born to the cow, then the bailee is bound to deliver the calf as well as the cow to the bailor. In other words, the pledge extends to accretions and additions, and therefore, when the pawnee returns the pledged goods, the accretions and additions must be returned to the pawnor. It also follows that the pawnee's right to retain and sell the pledged goods stretches to the right to retain and sell any increase and accumulations to the pledged goods.

29 (2000) 6 SCC 427.

6.2 Accordingly, in ***Seth Motilal Hirabhai and Ors.*** v. ***Bai Mani***,[30] where the shares were already pledged, it is held that when fresh shares were issued taking the call money from the yearly dividend payable on the old shares, the new shares must be returned to pawnor along with the old shares. Similarly, the Delhi High Court in ***M.R. Dhawan*** v. ***Madan Mohan and Others***,[31] has held that any accretion in the shape of dividends, bonuses or right shares issued in respect of the pledged shares, in the absence of any contract to the contrary, is the special property of the pawnee as a security for the debt.

(iv) <u>Notice of sale by pawnor and the pawnee's right to sue for recovery and sell the pawned goods</u>

7.1 Relying upon ***Lallan Prasad*** (supra) and ***Bank of Bihar*** (supra), this Court in ***Balkrishan Gupta and Others*** v. ***Swadeshi Polytex Ltd. and Another***[32] has held that under Section 176, if the pawnor makes default in payment of the debt or performance as promised, and in respect of which the goods were pledged, the pawnee may bring a suit on the pawnor upon the debt or promise and may retain the goods pledged as collateral security, or the pawnee may sell the things pledged on giving the pawnor reasonable notice of sale.

30 1924 SCC OnLine PC 81.
31 AIR 1969 Del 313.
32 (1985) 2 SCC 167.

7.2 Several High Courts in ***F. Nanak Chand Ramkishan Das of Hodel and Others*** v. ***Lal Chand and Others***,[33] ***Bank of Maharashtra*** v. ***M/s. Racmann Auto (P) Ltd.***[34] and ***Rani Leasing & Finance Ltd.*** v. ***Sanjay Khemani***[35] have held that while the pawnee has a right to sell the goods after giving notice to the pawnor, he is not bound to sell at any particular time. The power of sale conferred on the pawnee is expressly for his benefit, and it is his sole discretion to exercise the power of sale or otherwise. If the pawnee does not exercise that discretion, no blame can be put on him. Even where the value of the goods deteriorates due to time, no relief can be granted to the pawnor against the pawnee as the pawnor is legally bound to clear the debt and obtain possession of the pawned goods.

7.3 A Division Bench of the Calcutta High Court in ***Hulas Kunwar*** v. ***Allahabad Bank Ltd.***[36] has held that law does not require that the pawnee arrange for a sale beforehand and then give notice to the pawnor as to the date, time and place of sale. Notice under Section 176 has to be given of the pawnee's intention to sell in default of payment by the pawnor within the specified time. This

33 1958 SCC OnLine Punj 6.
34 AIR 1991 Del 278.
35 2015 SCC OnLine Cal 450.
36 AIR 1958 Cal 644.

notice does not require specification of the date, time and place of sale.

7.4 The Calcutta High Court in ***Haridas Mundra*** v. ***National and Grind-Lays Bank Ltd.***[37] refers to two earlier decisions in the cases of ***Hulas Kunwar*** (supra) and ***Kunj Behari Lal v. The Bhargava Commercial Bank, Jubbulpore***[38] where the courts have held that the notice under Section 176 is required before the sale to show the pawnee's intention to sell the good in order to give the pawnor reasonable information to redeem the pawned goods. Further, the reasonableness of notice may vary from case to case. The right to retain the pawn and the right to sell is alternative and not concurrent. When the pawnor retains, he does not sell, but when he sells, he does not retain the pledged goods. However, the pawnee can sue on the debt or the promise concurrently with his right to retain the pawn or sell it. Even the sale of the pawn does not destroy the pawnee's right as the pawn is a collateral security, and the pawnor remains liable on the original promise to pay the balance due. The right to sell the pawned goods is necessary to make the security effectual for discharging the pawnor's obligation. It continues despite the institution of a suit for recovery of the dues.

37 AIR 1963 Cal 132.
38 AIR 1918 All 363 (2).

7.5 In ***Vimal Chandra Grover*** v ***Bank of India***,[39] specific reference was made to the decisions on the law of pledge that the pawnee is under no compulsion to sell the pawned goods on the request of the pawnor as a means of discharging the debt. The reason is that Section 176 grants an option to the pawnee to either retain or sell the pawned goods for recovery of the debt. In the former case, the pawnee can also file the suit to recover debt while holding the goods. However, giving of reasonable notice to the pawnor for sale is required, but even when reasonable notice for sale has been given, the pawnee is not bound to sell the goods after the expiration of the period mentioned in the notice. At the same time, before the pledged goods are put to sale, the pawnor is entitled to redeem the pawned goods. The pawnor has the right to redeem them after discharging the debt. However, the court did not consider it necessary to go into legal niceties in view of the facts of the case as the bank, as a pawnee, on the request of the borrower-pawnor had agreed to sell a part of the shares to redeem the debt. In ***Vimal Chandra*** (supra), the Court held that the bank as the pawnee was liable for negligence as it did not sell the pledged goods, after having agreed to do so. This failure

39 (2000) 5 SCC 122.

amounted to negligence in service under the Consumer Protection Act, 1986.

7.6 At this stage we must refer to two detailed judgments of the Bombay High Court and the Delhi High Court and the observations of the Andhra Pradesh High Court in ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu*** (supra). In ***The Official Assignee of Bombay*** v. ***Madholal Sindhu and Others***,[40] the judgment of the Bombay High Court authored by Chief Justice Leonard Stone referred to the Commentaries on the Law of Bailments, Eighth Edition, by Mr. Justice Story, wherein it is observed on page 262:

> "Another right resulting, by the common law, from the contract of pledge is the right to sell the pledge, where there has been a default in the pledge in complying with his engagement, but a sale before default would be a conversion. Such a right does not divest the general property of the pawner but still leave in him (as we shall presently see) a right of redemption."

The following passage at page 263 was quoted:

> "The common law of England, existing in the time of Glanville, seems to have required a judicial process to justify the sale, or at least to destroy the right of redemption. But the law as at present established leaves an election to the pawnee. He may file a bill in equity against the pawner for foreclosure of sale and sale; or, he may proceed to sell *ex mero motu*, upon giving notice of his intention to the pledger."

40 AIR 1947 Bom 217.

In this case, the judgment of Chief justice Leonard Stone also referred to Section 1 of the Contract Act, which reads,

> "1. **Short title**.— This Act may be called the Indian Contract Act, 1872.
>
> **Extent, Commencement**.— It extends to the whole of India except the State of Jammu and Kashmir; and it shall come into force on the first day of September, 1872.
>
> **Saving** — Nothing herein contained shall affect the provisions of any Statute, Act or Regulation not hereby expressly repealed, nor any usage or custom of trade, nor any incident of any contract, not inconsistent with the provisions of this Act."

to hold that the instrument of pledge therein, giving unqualified power of sale, being inconsistent with Section 176, was not valid, and the express provision of Section 176 shall prevail. The notice must be given in all pledge cases, even when the instrument of pledge contains an unconditional power of sale. Another important observation made in this judgment is that the pawnor's right to redeem remains until the 'lawful sale'.

Chief Justice Stone's judgment is also relevant for another reason. He has referred to, with approval, Mr. Justice Story's commentaries on the Law of Bailments, Eight Edition, which at page 262 draws distinction between (actual) sale and conversion by the pawnee in the following passage:

> "Another right resulting, by the common law, from the contract of pledge is the right to sell the pledge, where

> there has been a default in the pledge in complying with is engagement, but a sale before default would be a conversion. Such a right does not divest the general property of the pawner but still leave in him (as we shall presently see) a right of redemption."

Chagla J., in his concurring opinion, referring to Section 176, held that when the pawnor makes a default in the payment of the debt, the pawnee may sell the pawned goods on giving the pawnor reasonable notice of sale. He agreed that the requirement of giving the pawnor reasonable notice of sale is mandatory and it is not open to the parties to contract themselves out of this section. Section 176 of the Contract Act, unlike some of the sections of the Contract Act, does not specifically provide that the contractual terms can override the provision by using the expression "in the absence of the contract to the contrary" or "subject to special contract to the contrary". The notice, that is to be given for the intended sale by the pawnee, is a special protection that the statute has given to the pawnor, and the parties cannot agree that the pawnee may sell the pledged goods without notice to the pledgor. Dwelling on the aspect of the pawnor's right of redemption under Section 177, the judge held that the right remains till the 'actual sale' of the pledged goods. The expression 'actual sale' in Section 177 must be a sale in conformity with the provisions of Section 176 which gives the pledgee the right to sell;

and if the sale is not in conformity with those provisions, then the equity of redemption with the pledgor is not extinguished.

The sale by the pawnee to himself being void does not put an end to the pledge, but the pawnor is bound by resale(s) duly effected by the pawnee to the third parties after such abortive sales to himself.

Chagla J. on the rights of the pawnee held that the Contract Act provides two rights to the pawnee when the pawnor makes a default in payment of the debt: (a) bring the suit against the pawnor for the debt and retain the goods pledged as collateral security; and (b) sell the goods pledged, which power, however, can be exercised in terms of Section 176 on giving the pawnor a reasonable notice for sale.

While upholding that the right of redemption given to the pawnor *vide* Section 177 of the Contract Act ends on the sale of the goods by the pawnee in conformity with the requirements of Section 176 of the Contract Act and not on unlawful or unauthorised sales, Chagla J. after extensively referring to the case law on the subject held that: (1) the pawnor does not become entitled to the possession of the goods pledged without tendering the amount due on the pledge; or in other words,

without seeking to redeem the pledge; and (2) that without a proper tender of the amount due on the pledge, the only right of the pawnor in respect of the unlawful or unauthorised sale is in tort for damages actually sustained by him. Therefore, without tendering the amount, action of trover[41] and detinue[42] are not maintainable.

7.7 The decision in ***Madholal Sindhu*** (supra) was carried in appeal to the Federal Court, wherein the court by majority overruled the decision of the Bombay High Court solely on a factual basis that, given the assent of sale of shares by the pawnor therein and the acquiescence thereof by the Official Assignee, the sale was good. However, it is to be espied that the question of whether the pawnor could enter into a contract contrary to the provisions of Section 176 or whether want of notice is a mere irregularity not affecting the title of the bona fide purchaser for value did not arise for consideration before the Federal Court.

7.8 These principles interpreting Sections 176 and 177 of the Contract Act are reiterated and affirmed in ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu*** (supra). This decision also examines the waiver of the right to reasonable notice under

41 A common law action to recover the value of personal property that has been wrongfully disposed of by another person.
42 A common law action for recovery of personal chattel wrongfully detained or of its value.

Section 176 of the Contract Act. Reference was made to the rule of waiver as stated in Maxwell on Interpretation of Statutes[43] in the following words:

> "Every-one has a right to waive and to agree to waive the advantage of a law or rule made solely for the benefit and protection of the individual in his private capacity, which may be exercised with without infringing any public right of public policy".

After referring to foreign[44] and Indian authorities[45] on waiver, ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu*** (supra) categorically observes that in terms of Section 176, its requirements are mandatory and that, even if there is a term in the contract of a pledge to waive notice, still, the pledgee is not relieved of his obligation to give notice before the sale.

7.9 Of particular importance is the reference in ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu*** (supra) to the following observations of Farelli J. in ***Soho Square Syndicate Ltd.*** v ***Poland & Co.***:[46]

> "If it be right to say that a mortgagee, by merely getting the consent of the mortgagor, can avoid the ..... necessity of applying to the Court. a large part of the protection which this Act was intended to provide would virtually disappear. People in the position of

43 (1953), 10th Edition, Sweet & Maxwell, page 368.

44 *Wilson* v. *Mcintosh*, 1894 A.C. P. 129.; *Corporation of the City of Tornoto* v. *John Russel*, D. Jones & Smiths Reports, 1908 Ac. 493; *Selwyn* v. *Grafit*, 38 Ch. D.P. 273; *Griffiths* v. *The Earl of Dudley*, 9, Q.B.D. P. 357.

45 *Vellayan Chettiar* v. *Government of the Province of Madras*, I.L.R. 1948 Mad. p. 214; *Raja Chetty* v. *Jagannadhadas Govindas*, 1949 II M.L.J. P. 694.

46 1940-1 Ch 638 at p. C43

> such persons as I have mentioned might easily be persuaded to give a consent without really knowing what exactly was involved in such consent, and an opportunity of expressing their reasons for their inability to pay, whatever they may he, and of stating their difficulties, which is now afforded to them by the necessity of an application to the court would be entirely removed. Moreover, difficult questions might also arise whether the consent had in fact been obtained, or whether it was a consent which was binding, and similar questions."

Where the Contract Act prescribes a particular term that is binding, the statutory mandate must be followed by the parties. Neither party can contract out of it. Otherwise, the legislative command that the statute imposes would be violated with immunity by merely incorporating waiver as a contractual term, depriving the frailer party of the benefit of the legal protection. A condition prescribed to protect and benefit the public cannot be dispensed with when it lays down a rule of public policy.

7.10 Section 63[47] of the Contract Act governs the domain of waiver. It is a general principle of law that everyone has a right to waive the advantage of a law or rule made solely for the benefit and protection of the individual in his private capacity.[48] However, such a waiver cannot infringe any public right or public policy. In

47 63. Promise may dispense with or remit performance of promisee.— Every promisee may dispense with or remit, wholly or in part, the performance of the promisee made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit.
48 *Cuilibet licet renuntiare juri pro se introducto* i.e., Any one may waive or renounce the benefit of a principle or rule of law that exists only for his protection.

Krishna Bahadur v. ***Purna Theatre and Others***,[49] this Court observed that,

> "10. A right can be waived by the party for whose benefit certain requirements or conditions had been provided for by a statute subject to the condition that no public interest is involved therein. Whenever waiver is pleaded it is for the party pleading the same to show that an agreement waiving the right in consideration of some compromise came into being. Statutory right, however, may also be waived by his conduct."

In Halsbury's Laws of England,[50] it is stated thus:

> "As a general rule, any person can enter into a binding contract to waive the benefits conferred upon him by an Act of Parliament, or, as it is said, can contract himself out of the Act, unless it can be shown that such an agreement is in the circumstances of the particular case contrary to public policy. Statutory conditions may, however, be imposed in such terms that they cannot be waived by agreement, and, in certain circumstances, the legislature has expressly provided that any such agreement shall be void."

However, there is a difference between statutory provisions meant for the benefit of a person and statutory provisions which mandate contracts to be in a specific manner. One cannot waive the statutory obligations where the statute restraints explicitly or mandates parties to contract in a particular manner. Formalities and requirements for making contracts have generally been held to be mandatory.[51] Where a statute prescribes that a contract shall be in a specific form or shall or shall not contain certain terms, the

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49 (2004) 8 SCC 229.

50 Vol. 8, Third Edn., para 248 at p. 143.

51 G.P. Singh, *Principles of Statutory Interpretation*, 14th Edition, Lexis Nexis (2016) at page 462.

statutory form must be followed.[52] In reference to pledge, waiver by contract and statutorily mandated terms, the High Court of Calcutta in ***The Co-Operative Hindusthan Bank, Ltd.*** v. ***Surendranath De***,[53] observed:

> "Section 176 of the Contract Act, unlike some other sections, *e.g.*, sections 163, 171 and 174, does not contain a saving clause in respect of special contracts contrary to its express terms. The section gives the pawnee the right to sell only as an alternative to the right to have his remedy by suit. Besides, section 177 gives the pawner a right to redeem even after the stipulated time for payment and before the sale. In our opinion, in view of the wording of section 176 as compared with the wordings of the other sections of the Act, to which we have referred, and also, in view of the right which section 177 gives to the pawner, and, in order that the provision of that section may not be made nugatory, the proper interpretation to put on section 176 is to hold that, notwithstanding any contract to the contrary, notice has to be given."

Even when the general law provides liberty to contract, the parties cannot contract contrary to express provisions of law. In ***Park Street Properties Private Limited*** v. ***Dipak Kumar Singh and Another***,[54] in reference to Section 106 of the Transfer of Property Act, 1882, this Court held:

> "While the agreement dated 7-8-2006 can be admitted in evidence and even relied upon by the parties to prove the factum of the tenancy, the terms of the same cannot be used to derogate from the statutory provision of Section 106 of the Act, which creates a fiction of tenancy in the absence of a registered instrument creating the same. If the argument advanced on behalf of the respondents is taken to its

52 Craies on Statute Law by S.G.G. Edgar, 7th Edition, Sweet & Maxwell Limited (1971) at page 255.
53 1931 SCC OnLine Cal 224.
54 (2016) 9 SCC 268.

> logical conclusion, this lease can never be terminated, save in cases of breach by the tenant. Accepting this argument would mean that in a situation where the tenant does not default on rent payment for three consecutive months, or does not commit a breach of the terms of the lease, it is not open to the lessor to terminate the lease even after giving a notice. This interpretation of Clause 6 of the agreement cannot be permitted as the same is wholly contrary to the express provisions of the law. The phrase "contract to the contrary" in Section 106 of the Act cannot be read to mean that the parties are free to contract out of the express provisions of the law, thereby defeating its very intent."

7.11 In ***Nabha Investment Pvt. Ltd.*** v. ***Harmishan Dass Lukhmi Dass***,[55] a decision of Delhi High Court, reference is made to the decision in ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu*** (supra) wherein the High Court of Andhra Pradesh had agreed with the opinion expressed by Chagla J. in ***Madholal Sindhu*** (supra), that in cases of unauthorized sale by the pawnee, the pawnor could seek to file a suit for redemption by depositing the money, treating the sale as if it had never taken place, or where the suit of redemption is not filed, to ask for damages on the ground of conversion. However, the decision in ***Nabha Investment*** (supra) disagreed with the view taken in these two judgments that the pawnor cannot file the suit for redemption of the pledge unless preceded by tender or accompanied by pledged money. Nevertheless, the judgment agrees with other principles of law laid down by Chagla J. that Section 176 is

55 1995 SCC OnLine Del 239.

mandatory observing that the applicability and sweep of Section 176 is not eclipsed or curtailed by the phrase “in the absence of the contract to the contrary”. In other words, the parties cannot contract out of Section 176. The need for notice to the pawnor of the intended sale by the pawnee is the special protection given to the pawnor, and the parties cannot override the special protection by agreement. Further, the right to redeem can be exercised up to the actual sale of the goods pledged, i.e., the sale referred to in Section 177 in conformity with Section 176. The judgment in ***Nabha Investment*** (supra) elucidates:

> “22.8. Here I may utilize this opportunity for extracting other principles of law laid down by Chagla, J. in his illuminating judgment which are based on several authorities. They are:—
>
> (i) The provisions of Section 176 Contract Act are mandatory. The applicability and sweep of Section 176 unlike several other provisions on the same subject is not eclipsed by the phrase-“in the absence of a contract to the contrary.” The notice that is to be given to the pledgor of the intended sale by the pledgee is a special protection which statute has given to the pledgor and parties cannot agree that in the case of any pledge, the pledgee may sale the pledged articles without notice to the pledgor (para 55).
>
> (ii) If a sale is held of the shares under authority of the pledgor then it could convey to the purchaser full title in the shares; sale under Section 27 of Sale of Goods Act title conveyed to the purchaser would not be a title better than that of the seller. (Para 56).

(iii) Notice under Section 176 of Contract Act must be given before the power of sale can be exercised. If the notice is essential, the purchaser, however innocent cannot acquire a title better than his vendor has (Para 56).

(iv) Right to redeem under Section 177 can be exercised right upto time the actual sale of the goods pledged takes place. The actual sale referred to in Section 177 must be a sale in conformity with the provisions of Section 176 which gives the pledgee the right to sale; and if the sale is not in confirmity with those provisions, then the equity of redemption in the pledgor is not extinguished (para 57).

(v) The pledgor has a right to call upon the pledgee to redeem the shares or payment of the debt. If the pledgee has transferred the shares, he is entitled to call upon the transferee for the same because the transferee does not acquire anything more than the right, title and interest of the pledgee which is to retain the goods as a pledge till the debt is paid off. If the pledgor may not be in a position to redeem, he may contend himself with merely suing the pledgee for conversation if any damage has resulted by reason of the goods being sold without proper notice (para 59).

(vi) There is no analogy between Section 69(3) of T.P. Act and Section 176 Contract Act; there is a marked contrast between the two. Former protects the innocent purchaser, the latter does not do so. In the absence of any provision in Section 176 of the Contract Act in favour of the innocent purchaser, to import such protection from the provisions of another statute is with respect wholly fallacious and unjustifiable. It is always dangerous to draw analogy between one statute and another;

22.9 Vide para 64 Chagla, J. did not agree with the following statement of law contained in Coote on Mortgages (Volume-II, 9th Edition page 1472):—

> "The pledgee has on default a right to sell the pledge if the payment is to be made on a certain day; otherwise not; but a sale before default would be a conversion; yet the sale, whether wrongful or not, passes the title to the vendee as against the pledgor.
>
> 22.10 Chagla, J. has expressed his approval and agreement with the following statement of law in Story's Law of Bailments, (8th Edition, page 272):—
>
> "A pledgee of stock has no legal right to sell the same without notice to the pledgor and such sale passes no title as against the pledgor, even to a bonafide party".
>
> 22.11 The abovesaid principles deducible from the opinion recorded by Chagla, J. with which I find myself in full agreement lend strength to the plaintiff's case…."

7.12 The view of the Delhi High Court in ***Nabha Investment*** (supra) expressing limited divergence[56] from the ratio in ***Madholal Sindhu*** (supra) and ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu*** (supra) does not appeal to us. The reason given by the Delhi High Court that there is no provision in any statute or principle of law to hold that the pawnor has only two remedies, as elucidated by Chagla, J. in ***Madholal Sindhu*** (supra), is not correct. Section 177, which gives right of redemption to the pawnor till 'actual sale', itself postulates not only payment of the debt due but also expenses of the pawnee which have arisen from the pawnor's default. The instances noted subsequently when the pawned property is not available are well

56 See paragraphs 22.7, 23 and 24 of the judgment in *Nabha Investment.*

covered and can be taken care under clause (2)[57] of the opinion expressed by Chagla, J. in ***Madholal Sindhu*** (supra).[58]

7.13 Section 176 of the Contract Act requires that the pawnee may sell the thing pledged on giving the pawnor reasonable notice of the sale. It does not prescribe any fixed form of notice or specify any fixed period of notice. The object and purpose of giving notice is to make the pawnor know about the pawnee's intent to sell the pawn and give him an opportunity to exercise his statutory right of redemption, which as per Section 177 can be exercised till the date of 'actual sale'. Whether or not a notice was given and the period of notice was reasonable would depend upon the facts of the case. In view of the above discussion, the pawnor can communicate his willingness and desire to the pawnee that the pledged goods may be sold. In case any such request is made, a pawnee may well act upon the request without violating Section 176 of the Contract Act. However, a pawnee, unless he also

57 (2) that without a proper tender of the amount due on the pledge, the only right of the pawnor in respect of the unlawful or unauthorised sale is in tort for damages actually sustained by him.

58 The reliance placed on the Madras High Court decision in *S.L. Ramasamy Chetty* (supra) would not help as the decision is in conformity with the view expressed by Chagla, J. that the pawnor does not become entitled to redemption of the goods pledged without tendering the amount due on the pledge. The Madras High Court in *S.L. Ramasamy Chetty* (supra) did not hold that the pawnor is entitled to redemption of the pledged goods without payment of the debt due and the additional amount. The Court would be entitled to ask the pawnor to deposit the 'admitted amount' at the initial stage itself if the pawnee is ready and willing to deliver the property pledged. The position would be different where the pawnee declares in advance his inability to return the pledged property, in which case the pawnor's claim cannot be defeated through a useless ceremony of tender. Section 51 of the Contract Act relating to reciprocal promises was relied upon.

agrees, cannot be compelled by the pawnor to sell the pledged goods.

(v) Sale of the pledged goods by the pawnee to self

8.1 Dictum in the above judgments and Section 177 of the Contract Act, which confers on the defaulting pawnor the right to redeem the pledged goods till 'actual sale', does not support pawnee's sale to self. Sale to self would in terms of the judgment in ***Madholal Sindhu***'s case (supra) is a case of conversion and not 'actual sale', and therefore, would not affect the pawnor's right to redemption under Section 177 of the Contract Act. Judgment of the Calcutta High Court in ***Haridas Mundra*** (supra) also states this rule. Earlier, the Privy Council in ***Neikram Dobay*** v. ***Bank of Bengal,***[59] observed that the sale of goods by the bank as the pawnee to itself is unauthorized but did not entitle the pawnor to have the goods back. The pawnor would be required to pay back the debt for which the goods were pledged as security to redeem the goods. If the loan remains unpaid after the demand, the pawnee is entitled to sell the goods and credit the proceeds towards the outstanding debt. After the goods are sold to a third party, the pledge ends. The pawnee in such cases would be liable if he fails to credit the loan account with the proceeds on the sale

59 ILR (1892) 19 Cal 322.

of the pawned goods. The pawnee may also be liable, subject to the contract, for damages for converting the goods for his use.

8.2 Several other High Courts have similarly opined and we agree that the Contract Act does not conceive of sale of the pawn to self and consequently, the pawnor's right to redemption in terms of Section 177 of the Contract Act survives till 'actual sale'. In ***Ramdeyal Prasad*** v. ***Sayed Hasan***,[60] the Patna High Court has held that the sale by the pawnee to himself of the securities pledged is void; it does not put an end to the contract of the pledge to entitle the pawnor to recover the goods without payment of the amount thereby secured, nor does it entitle the pawnor to damages. The pawnor is bound by the resale duly effected by the pawnee to third persons. However, where the pawnee has erroneously represented to the pawnor before such resales that the securities have been sold and, therefore, no longer available for redemption, the pawnee becomes liable for the value as conversion.

8.3 A Division Bench of the Madras High Court in ***S.L. Ramaswamy Chetty and Another*** v. ***M.S.A.P.L. Palaniappa Chettiar***,[61] relying upon the decision of the Privy Council in ***Neikram Dobey*** (supra), opined that where the pawnee has the power to sell in default,

60 AIR 1944 Pat 135.
61 1929 SCC OnLine Mad 62.

takes over upon himself the property pledged without the authority of the pawnor by crediting its value in the account with him, this act, though an unauthorized conversion would not put an end to the contract of pledge.[62]

8.4 There is one solitary judgment of the single judge of the Punjab and Haryana High Court in ***Dhani Ram and Sons*** v. ***The Frontier Bank Ltd. and Another***,[63] which holds that the sale of the pawned goods by the pawnee to himself is not void, and the pawnee was held to be the legal owner of the pledged shares. This decision proceeds with the incorrect understanding of the ratio in ***Neikram Dobay*** (supra), and thus, we deem it appropriate to overrule this ratio in ***Dhani Ram and Sons*** (supra).

D. Effect and Purpose of the Depositories Act, 1996 and the Securities and Exchange Board of India (Depositories and Participants) Regulation 1996.

9.1 Interpretation of statutes must depend on the text and the context. To resolve a debate when two views are evident, it is best to interpret the provision when we know why the statute is enacted. If a statute is looked at, in the context of its enactment, with the glasses of the statute-maker provided by such context, its

62 This decision also holds that the pawnor would be entitled to redeem without payment. This proposition is contrary to several decisions including decision of the Privy Council in *Neikram Dobey* (supra).
63 AIR 1962 P&H 321.

scheme, the sections, clauses, phrases and words may take colour and appear different than when the statute is looked at without the glasses provided by the context.[64] This principle may equally apply when we examine interplay between two statutes. The provisions of the Contract Act, which is substantive and general law relating to contracts, and the Depositories Act, which is a primarily a law relating securities, must be interpreted harmoniously. This does not mean that any provision of one enactment could nullify the provisions of the other. This end can be best achieved by examining the objects and the subject matter of the Depositories Act *vis-a-vis* the Contract Act, which will clarify their separable spheres of operation to avoid any conflict or overlap between them. It means that the two statutes shall be read together consistently and harmoniously to complement each other so far as it is reasonably possible to do so, and where such conciliation is not possible to clarify the legal position by application of principles of interpretation applicable to such situations.[65]

9.2 Thus, we begin by referring to the object and purpose behind the enactment of the Depositories Act and which would underpin our

64 *Reserve Bank of India* v. *Peerless General Finance and Investment Co. Ltd. and Others*, (1987) 1 SCC 424, para 33.
65 *Vasudev Ramachandra Shelat* v. *Pranlal Jayanand Thakkar and Others*, (1974) 2 SCC 323, para 5.

interpretation of the 1996 Regulations. Introduction to the Depositories Act refers to one of the major drawbacks of the then Indian securities market, which was paper-based. Consequently, there was a lack of assurance and certainty in the transfer of securities due to risks in the form of 'bad delivery', forgery, theft etc. As a result, the investors suffered and were deprived of liquidity in securities and the grievance redressal was intractable. In turn, the capital market also felt pain due to lack of confidence and consequently, the growth was cramped. To pave the way for smooth, fast and constancy in the transfer of securities and to promote and deal with an increase in trading of stocks and shares in a transparent manner, there was a need for regulating the methodology of trading of securities.

9.3 The Depositories Act is enacted to lay down a process and rules for the dematerialization of securities by converting them into electronic data stored in the computers of 'the depository'.[66] The Depositories Act establishes the depository eco-system and introduces the concepts of a 'registered owner'[67] and 'beneficial owner'.[68] Every owner of a physical share has to enter into an

66 Section 2(1)(e): "depository" means a company formed and registered under the Companies Act, 1956 (1 of 1956) and which has been granted a certificate of registration under sub-section (1-A) of Section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992).
67 Section 2(1)(j): "registered owner" means a depository whose name is entered as such in the register of the issuer;
68 Section 2(1)(a): "beneficial owner" means a person whose name is recorded as such with a depository;

agreement with ‘the depository’ for availing its services. The physical certificate of security is cancelled. All securities held by ‘the depository’ are in a fungible form. ‘The depository’ becomes the ‘registered owner’ in respect of the security, whereas the person who surrenders the physical shares is recorded as ‘the beneficial owner’. ‘The depository’, as the registered owner, does not have any voting right or any other right in respect of the securities held by it. ‘The beneficial owner’ shall be solely entitled to all rights, benefits, and liabilities attached to the securities held by ‘the depository’. In terms of Section 11, every depository is mandated to maintain a register and index of ‘beneficial owners’ in the manner provided in Sections 150, 151 and 152 of the Companies Act, 1956. As per Section 7[69] of the Depositories Act, every 'depository', on receipt of intimation from a participant, is required to transfer the security in the transferee’s name. Further, on registration of transfer of security in the transferee’s name, the transferee is registered as the ‘beneficial owner’.

9.4 Power and right to transfer ownership of a dematerialised security vests with the ‘beneficial owner’, same as in the case of buying and selling physical securities. The difference lies in the delivery

69 7. Registration of transfer of securities with depository:
(1) Every depository shall, on receipt of intimation from a participant, register the transfer of security in the name of the transferee.
(2) If a beneficial owner or a transferee of any security seeks to have custody of such security, the depository shall inform the issuer accordingly.

process in case of sale, and receipt in case of purchase, which is affected by the depository on instructions from the participant. Every person recorded as the 'beneficial owner' to transact and deal in securities must act through a participant who is an agent of the depository. Section 10[70] states that notwithstanding any other law for the time being in force, 'the depository' shall be deemed as the 'registered owner' and is entitled to affect the transfer of ownership of the security on behalf of 'the beneficial owner'. No person, including the pawnee, can transfer the pawn held in dematerialised form without being registered as a 'beneficial owner'.

9.5 Section 12 of the Depositories Act permits pledge and hypothecation of securities held by a depository and reads:

> "**12. Pledge or hypothecation of securities held in a depository:**
>
> (1) Subject to such regulations and bye-laws, as may be made on this behalf, a beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository.
>
> (2) Every beneficial owner shall give intimation of such pledge or hypothecation to the depository and such

70 10. Rights of depositories and beneficial owner:
(1) Notwithstanding anything contained in any other law for the time being in force, a depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner.
(2) Save as otherwise provided in sub-section (1), the depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it.
(3) The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

depository shall thereupon make entries in its records accordingly.

(3) Any entry in the records of a depository under sub-section (2) shall be evidence of a pledge or hypothecation."

In terms of sub-section (1) of Section 12, a 'beneficial owner' can create a pledge or hypothecation regarding the security owned by him through 'the depository', subject to prior approval of 'the depository'. Section 12 or for that matter the Depositories Act does not define pledge or hypothecation, and thereby accepts and adapts their meaning as known in the commercial sense to people in the trade. This means that the Depositories Act recognises the principles relating to pledge prescribed by the Contract Act and the common law. Depositories Act states that such a pledge or hypothecation should be made in accordance with the regulations and by-laws made under the Depositories Act. A 'beneficial owner' as the pawnor is required to intimate such pledge or hypothecation to the depository, which thereupon makes entries in its records. This entry, made by 'the depository', is evidence of pledge or hypothecation.

9.6 Prior to the Depositories Act, physical shares and securities were pledged and such transactions have resulted in several decisions of the Supreme Court and the High Courts. In most cases, the

pledge of shares was accompanied by blank transfer deeds, and consequent dispute as to the correct nature of the transaction as was the case in ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu*** (supra), ***Mohd. Sultan and Ors.*** (supra) and even in ***Madholal Sindhu*** (supra). In ***Sri Raja Kakarklhpudi Venkata Sudarsana Sundara Narasayamma Garu*** (supra), the Andhra Pradesh High Court, after referring to ***Madholal Sindhu*** (supra), agreed with the view expressed in ***Kannambra Nayar Veetil Valia Ammukutti Neithiar's Son Kunhunni Elaya Nayar Avargal (Deceased) and Another*** v. ***P.N. Krishna Pattar and Two Others***[71] that such transactions because of execution of the blank transfer deeds should not be treated as mortgages. A pledge of shares can be accompanied by execution of blank transfer deeds, which was a convenient mode of exercising the right to sell when the pawnee is entitled to do so. In absence of blank transfer deeds, the pawnee must take recourse to the court when he wishes to enforce the securities.

9.7 Clearly, Section 12 of the Depositories Act is not *ex-facie* inconsistent with pawnee and pawnor's contractual rights and obligations under the Contract Act and the common law. On the other hand, the Depositories Act expressly concedes that the

71 AIR 1943 Mad 74.

securities held by the depository can be pledged and hypothecated by the 'beneficial owner'. It simplifies the process by bringing transparency and certainty. It checks and curtails possibilities of disputes as the pledge must be registered with the 'depository.'

9.8 Undoubtedly, the Depositories Act distinguishes between the 'registered owner' and the 'beneficial owner', i.e., the *de facto* owner, but this does not in any manner contradict or lay down a rule which is contrary to the provisions of Sections 176 and 177 of the Contract Act. These sections, given the objective and purpose behind them, would still apply to any pledge deed and do not get diluted or overridden by the provisions or requirements of the Depositories Act. Section 10, a *non obstante* provision, which prevails over existing enactments by law, treats the 'depository' as the 'registered owner' and the shareholder/holder as a 'beneficial owner'. It does not undermine or rewrite the provisions of the law of pledge and mutual obligations and rights of the pawnee and pawnor. This aspect has been elaborated in some detail subsequently in this judgement.

9.9 Under Section 25 of the Depositories Act, the Securities and Exchange Board of India[72] has been vested with the power to

72 Hereinafter referred to as "Board".

make Regulations to carry out the purpose of the Depositories Act. Clause (d) to sub-section (2) to Section 25 states that the regulations may provide for the manner of creating a pledge or hypothecation in respect of a security owned by a 'beneficial owner' under sub-section (1) to Section 12 of the Depositories Act.

9.10 In exercise of this power, the Board notified the 1996 Regulations. The relevant portion of Regulation 58 reads as under:

> "58.
>
> xx xx xx
>
> (2) The participant after satisfaction that the securities are available for pledge shall make a note in its records of the notice of pledge and forward the application to the depository.
>
> (3) The depository after confirmation from the pledgee that the securities are available for pledge with the pledgor shall within fifteen days of the receipt of the application create and record the pledge and send an intimation of the same to the participants of the pledgor and the pledgees.
>
> (4) On receipt of the intimation under sub-regulation (3) the participants of both the pledgor and the pledgee shall inform the pledgor and the pledgee respectively of the entry of creation of the pledge.
>
> (5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants of the pledgor and the pledgee.
>
> (6) The entry of pledge made under sub-regulation (3) may be cancelled by the depository if the pledgor or the pledgee makes an application to the depository through its participant:

> Provided that no entry of pledge shall be cancelled by the depository with the prior concurrence of the pledgee.
>
> (7) The depository on the cancellation of the entry of pledge shall inform the participant of the pledgor.
>
> (8) Subject to the provisions of the pledge document, the pledgee may invoke the pledge and on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.
>
> (9) After amending its records under sub-regulation (8) the depository shall immediately inform the participants of the pledgor and pledgee of the change who in turn shall make the necessary changes in their records and inform the pledgor and pledgee respectively."

A reading of Regulation 58 would show that a 'beneficial owner' is entitled to create a pledge on security owned by him. To do so, he must apply to the 'depository' through the participant who has his account in respect of the securities. Sub-regulation (2) requires the participant to accord its satisfaction that the securities are available for pledge and make a note in this regard in its records. The note is to be forwarded to the 'depository'. In terms of sub-regulation (3), the 'depository' is required to within fifteen days create and record a pledge and send an intimation to the participants of the pledgor/pawnor and the pledgee/pawnee. The participants of the pawnor and pawnee are required to inform the pawnor and the pawnee as to the entry of creation of the pledge. If the 'depository' does not create the pledge, intimation of

the reasons has to be given to the participants of the pawnor and the pawnee. The ‘depository’ can cancel the pledge if the pawnee applies to the depository through its participants. The pawnor can also apply through its participant to the ‘depository’ for cancelling the pledge. In this case, the entry can be cancelled by the ‘depository’ with the prior concurrence of the pawnee. On cancellation of the pledge entry, the ‘depository’ is to inform the participant of the pawnor.

9.11 Sub-regulation (8) to Regulation 58 uses the expression “subject to the provisions of the pledge document” with a specific purpose and objective. In other words, sub-regulation (8) to Regulation 58 does not seek to curtail or restrict, but on the other hand respects party autonomy and freedom to decide the terms of the pledge, including the event of default that would entitle the pawnee to invoke the pledge and sell the pawn. The sub-regulation does not expressly nullify any provision of the Contract Act. However, the stipulation that the pawnee may invoke the pledge, and on such invocation, the pawnee is to be recorded as the ‘beneficial owner’ of the pledged securities is mandatory. A pledge document cannot stipulate to the contrary, and any contravening contractual stipulation would not be binding. The records maintained by the ‘depository’ are to be amended on the pawnee invoking the pledge

and thereupon, the 'depository' shall register the pawnee as the 'beneficial owner' of the securities. Consequent to the change and in terms of sub-regulation (9) to Regulation 58, the 'depository' is to inform the participants of the pawnor and pawnee, with a direction that they shall make necessary changes in their records and that the participants shall inform the pawnor and pawnee, respectively.

9.12 Thus, the non-obstante part of sub-regulation (8) to Regulation 58 serves a limited objective and purpose: the pawnee must record itself as a 'beneficial owner' before he proceeds to sell the pledged securities. Without the pawnee being accorded the status of a 'beneficial owner', a pawnee cannot proceed to sell the pledged dematerialized securities. A contractual term cannot overwrite the requirement of Sections 7 and 10 of the Depositories Act, which is reflected in sub-regulation (8) to Regulation 58 as pe which the pawnee must be recorded as the 'beneficial owner' before the pledged dematerialized securities are sold. Section 38(1)(e) of the Depositories Act requires the 'depository' to maintain, *inter alia*, records of all approvals, notices, entries and cancellations of pledge and hypothecation, as the case may be. This mandate of sub-regulation (8) to Regulation 58 will apply whenever the pledged/pawned goods are dematerialized securities. To reiterate,

this requirement of sub-regulation (8) to Regulation 58 does not circumscribe or limit the contractual rights and obligations agreed upon between the parties on the agreed terms, including the pawnee's right to sell the pawned goods. While the contractual terms are fundamental and determine the rights and obligations *inter se* the parties including when the pawnee would be entitled to get his name substituted as a 'beneficial owner' under the 1996 Regulations, however, the contractual terms are not permitted to override the Contract Act as explained above in so far as it regulates the rights and obligations of the pawnee and pawnor, and the requirement of compliance with Regulation 58(8). It is absolutely necessary that the pawnee must be accorded status of 'beneficial owner' to enable him to exercise his right to sell the pledged dematerialized securities. The object is to ensure compliance with the procedure prescribed for the sale of dematerialised securities and not to interfere with the freedom to contract as long as they comply with the Contract Act and other laws. Further, if the terms of the pledge document violate Regulation 58(8), the pledge is not rendered void or illegal, *albeit* enforcement of the pledge *viz.* the dematerialised securities will be rendered unattainable unless steps are taken to act in accordance with the procedure prescribed by the 1996 Regulations. The

pawnee would be entitled to sue the pawnor for recovery of money, breach of contract and may even apply for injunction/restrain on sale of dematerialised securities. However, third-party rights on transfer of the dematerialized securities, unless injuncted by a prior court order, would not be affected as long as the transfers are in terms of the Depositories Act and the 1996 Regulations.

E. Effect of the Depositories Act, 1996 and the Securities and Exchange Board of India (Depositories and Participants) Regulation, 1996 on the pledge under the Contract Act, 1872

10.1 As per the 1996 Regulations, the pledgor/pawnor is not entitled to sell the pledged/pawned securities. The special rights of the pledgee/pawnee in the pawn remain intact under the Depositories Act and the 1996 Regulation. However, the right to sell dematerialized securities is conferred and given to the ‘beneficial owner’, who exercises this right through the participants. Consequently, if a pawnee wants to exercise his right to sell dematerialized security it is mandatory for the pawnee first to get himself recorded as a ‘beneficial owner’ in the ‘depository''s records. Without the said exercise, the pawnee cannot exercise its rights to sell the pledge and retrieve the monies due by taking recourse to its rights under Section 176 of the Contract Act. Right to sell the pledge after reasonable notice is one of the options,

albeit, both under the common law and under the Contract Act, the pawnee has the choice even after issue of notice for sale to sue for the debt due while retaining possession of the pledged goods. Similarly, the pawnor under the Contract Act and the common law has the right to redeem the pledged goods till 'actual sale'. Sale by the pawnee to self does not defeat the right of redemption of the pawnor. It may amount to conversion in law. Other provisions of the Contract Act enumerated in Chapter IX may well apply.

10.2 The Depositories Act (except for Section 10 which has been examined by us in some detail *in re* its application (supra)) and the 1996 Regulations do not expressly state that their provisions prevail over the Contract Act or any other law in force. On the other hand, Section 28 states that "the provisions of this Act shall be in addition to and not in derogation of any other law for the time force relating to the holding and transfer of securities." Thus, the Depositories Act is in addition to other laws relating to the holding and transfer of securities. Our reasoning does not mean that compliance with Section 12 and Regulation 58 is not compulsory or mandatory. Violations of the statute may lead to penalties and even criminal action when permitted and warranted. Nevertheless, given the nature and requirements under Section 12 or Regulation 58, do not by implication or due to conflict over-write and undo the

legislative mandate of Sections 176 and 177 of the Contract Act. We do not read any legislative intent in the Depositories Act and the 1996 Regulations to change the law of pledge requiring issue of reasonable notice; or as allowing sale to self, or abolishing the right of the pawnor to redeem the pledged goods till 'actual sale'. Sections 176 and 177 are not obliterated, in so far as they would equally apply to pawned dematerialised securities as they apply to other pawned goods.

10.3 The Depositories Act and the 1996 Regulations do not state or impliedly reflect that sale of the pledged securities by the pawnee to self, which amounts to conversion and does not affect the rights of the pawnor under Section 177, are no longer applicable. Doing so would tantamount to reading and adding words to Section 12 and Regulation 58 to defy Sections 176 and 177 of the Contract Act. Law of pledge is dynamic and as observed above must adapt itself in the context of the current commercial environment, *albeit* we would avoid palpable conflict that would arise in view of the enactment of the Depositories Act and the 1996 Regulations, or else the operation of law in practice would lead to compliance difficulties and complications. While interpretating the law relating to commercial matters and commerce the court must consider the real-world impact and consequences. Therefore, the expression

‘actual sale’ in Section 176 read in the context of the Depositories Act and the 1996 Regulations have to be given a meaning. The expression ‘actual sale’ used in Section 177 in our opinion should be read as ‘the sale by the pawnee to a third person made in accordance with the Depositories Act and applicable by-laws and rules’. It also means and requires compliance with Section 176 of the Contract Act. Mere exercise of the right by the pawnee to record himself as the ‘beneficial owner’, which is a necessary precondition before the pawnee can exercise his right to sell, is not ‘actual sale’ and would not affect the rights of the pawnor of redemption under Section 177 of the Contract Act. Every transfer or sale is not ‘actual sale’ for the purpose of Section 177 of the Contract Act. To equate ‘sale’ with ‘actual sale’ would negate the legislative intent.

10.4 In ***Madholal Sindhu*** (supra) and several other decisions, the expression ‘actual sale’ in Section 177 of the Contract Act has been interpreted to mean lawful sale to a third person and not conversion or unlawful sale contrary to Section 176 of the Contract Act. According to us, exercise of right on the part of the pawnee and consequent action on the part of the ‘depository’ recording the pawnee as the ‘beneficial owner’ is not ‘actual sale’. The pawnor’s right to redemption under Section 177 of the Contract Act

continues and can be exercised even after the pawnee has been registered and has acquired the status of ‘beneficial owner’. The right of redemption would cease on the ‘actual sale’, that is, when the ‘beneficial owner’ sells the dematerialised securities to a third person. Once the ‘actual sale’ has been affected by the pawnee, the pawnor forfeits his right under Section 177 of the Contract Act to ask for redemption of the pawned goods.

10.5 We, however, accept that the Depositories Act, by-laws and rules relating to sale of dematerialised securities would be gravely undermined in case the pawnor is entitled to redeem the dematerialised shares from the third party on the ground that reasonable notice, as postulated under Section 176 of the Contract Act, was not given to the pawnor. To this extent, we would accept that there is a conflict between the Depositories Act and the interpretation given in ***Madholal Sindhu*** (supra), which has been followed in other cases, including the judgment of the Delhi High Court in ***Nabha Investment*** (supra). If this principle is applied to dematerialised securities that have been transferred to the third parties in accordance with the provisions of the Depositories Act, by-laws and rules, it would materially impact certitude in the transaction in listed dematerialised securities which would become vulnerable to challenge even when the arm’s

length purchasers are innocent third-party buyers for valuable considerations. Open market operations would be affected. To this extent, therefore, we do hold that the dictum in ***Madholal Sindhu*** (supra) and ***Nabha Investment*** (supra), that the pawnor has a right to redemption against third parties when the pawnee does not give reasonable notice under Section 176 of the Contract Act, would not apply to listed dematerialised securities which are sold by the pawnee in accordance with the provisions of the Depositories Act, by-laws and rules. In fact, the stipulations in Section 12 of the Depositories Act and Regulation 58 of the 1996 Regulations have in built provisions in terms of which the pawnor and the pawnee are informed about the change of status with the pawnee making a request and being accorded a status of the 'beneficial owner'. The pawnee cannot make the sale of dematerialised securities without being registered as a 'beneficial owner', which is a step that a pawnee must take before he proceeds to sell the pledged dematerialised securities.

10.6 Beyond the additional need to comply with Sections 10 and 12 of the Depositories Act and Regulation 58 of the 1996 Regulations in specific terms, we do not see any disharmony between these provisions and Sections 176 and 177 of the Contract Act. They can be read harmoniously without nullifying or altering their effect,

subject to the exception in case of sale of listed securities to third parties in terms of paragraph 10.5 (supra). They apply independently without hindering and obstructing their application as the field and subject matter of Sections 176 and 177 of the Contract Act differ from the subject matter and the object of Sections 7, 10 and 12 of the Depositories Act and sub-regulation (8) to Regulation 58 of the 1996 Regulations.

F. Four decisions

11.1 The case of the Bombay High Court relied upon by the MHPL in ***JRY Investments Private Limited*** v. ***Deccan Leafine Services Ltd. and Others***[73] is distinguishable as it dealt with a different factual matrix. In the said case, there was a transfer of shares and not a pledge, a factum specifically noticed and held in terms of the finding recorded in paragraphs 16 to 20 of the said judgment.[74] However, certain observations are made concerning the Contract Act and the procedure prescribed for pledging the shares by the Depositories Act. The Court observed that the provisions of the Depositories Act are for accurately recording the transfer and pledging of shares held in dematerialized form. The Depositories

73 (2004) 121 Comp Cas 12.

74 "20. It does not appear that the transfer of shares in the present case can be taken to be a pledge in law. Therefore, there can be no question of applicability of Section 176 of the Contract Act which requires the pledgee to give a notice to the pledgor of his intention to transfer the pledged goods. This aspect is being considered because at one stage it was argued by learned counsel for the plaintiffs that the transfer by defendant No. 1 of shares in favour of the other defendants is void in the absence of the notice by defendant No. 1 of their intention to sell the shares."

Act contemplates the existence of a ‘depository’ that holds the shares in the name of the ‘beneficial owner’. The ‘depository’ acts as a ‘registered owner’ of the shares for effecting the transfer of ownership security on behalf of the ‘beneficial owner’ in terms of Section 10 of the Depositories Act. Section 10 is a *non-obstante* clause for the purpose of effecting the transfer of ownership of security on behalf of the ‘beneficial owner’. Accordingly, the transfer of shares must be done in accordance with the provisions of the Depositories Act, which means that a person recorded as a ‘beneficial owner’ alone can exercise the power of transfer. Thereafter, Regulation 58 is quoted. It is observed that the Depositories Act and the Regulations contain a whole and self-contained procedure for creating a pledge. This statement and the statement that the pledge of dematerialized securities would require compliance and creation in accordance with the provisions of the Depositories Act, are substantially correct, but have to be read and understood in terms our findings and opinion recorded above. However, we overrule this decision of the Bombay High Court to the extent it holds that dematerialised securities cannot be made subject matter of a pledge under the Contract Act as it is not possible to transfer physical possession. We have referred to the case law, including earlier judgments of this Court, in ***Lallan***

Prasad (supra) and ***Maharashtra State Co-operative Bank Limited*** (supra), which hold that delivery of possession of goods for pledge can be actual or constructive. In the case before the Bombay High Court, there was no pledge in terms of Regulation 58. On the other hand, the shares were transferred and held by the transferee as a 'beneficial owner' upon transfer. The final outcome, therefore, would remain undisturbed in spite of our finding.

11.2 In ***Pushpanjali Tie Up Pvt. Ltd.*** v. ***Renudevi Choudhary and Others***,[75] a Division Bench of the Bombay High Court had expressed reservation on the finding in ***JRY Investments Private Limited*** (supra) that the goods in dematerialised form cannot be pledged.[76] The said finding in ***JRY Investments Private Limited*** (supra) as held above is contrary to the view expressed by this Court in ***Morvi Merchantile Bank Limited*** (supra) and ***Bank of Bihar*** (supra). It would also be contrary to the principle that the Contract Act is not an exhaustive law on pledge and mortgage of movables. In ***Pushpanjali Tie Up Pvt. Ltd.*** (supra), the deed of pledge had permitted the lender to use the pawn as a collateral for his margin with the third party, which right had been exercised by

75 2014 SCC OnLine Bom 3661.

76 "25. *…….. For the purpose of this judgment, we refrain from expressing any opinion regarding the finding of the leaned single Judge in paragraph 16 that it is impossible to hold that the goods in dematerialized form are capable of delivery that is by handing over de-facto possession. We will presume that it is possible to do so……."*

the pawnee. In this background, the Court rejected the claim of the pawnor for the redemption of the pawn as the pawnee had transferred the rights in respect of the pawned shares by depositing them as margin with the third party. The view expressed was that the said transaction by the pawnee could not be ignored; otherwise, it would render the arrangement agreed upon as meaningless and devoid of commercial sense. This judgment also refers to an earlier decision of the Allahabad High Court in ***Firm Thakur Das Marakhan Lal*** v. ***Mathura Prasad and Others***,[77] which was a case in which the three ornaments had been sub-pledged. The debt payable having been extinguished by virtue of a debt redemption act, the pawnor had sued for recovery of the ornaments on the ground that the sub-pledges did not bind him. In this context, the Allahabad High Court had observed that Section 179 of the Contract Act clarifies that if a person has a limited interest in the goods and pledges them, the pledge is valid to the extent of that interest only. Reliance was placed on Judge Story's book on 'Bailments', which records as under:

> "The pawnee may by the common law deliver over the pawn to a stranger for safe custody without consideration; or he may sell or assign all his interest in the pawn; or he may convey the same interest conditionally by way of pawn, to another person without in either case destroying or invalidating his security. But if the pawnee should undertake to pledge

77 AIR 1958 All. 66.

> the property (not being negotiable securities) for a debt beyond his own, or to make a transfer thereof as if he were the actual owner, it is clear that in such case he would be guilty of a breach of trust, and his creditor would acquire no title beyond that held by the pawnee.
>
> Whatever doubt may be indulged in, in the case of a mere factor, it has been decided in the case of a strict pledge, that if the pledgee transfers the same to his own creditor the latter may hold the pledge until the debt of the original owner is discharged."

Significantly, regarding the Depositories Act and the 1996 Regulations, this judgment rightly observes that dematerialised shares must comply with the said pledge requirements to enable the pawnee to exercise the right to sell. A third party would be entitled to and justified in presuming that there is no pledge unless the procedure prescribed under the Depositories Act is followed. To this extent, the Depositories Act has introduced a new regime. The legislative intent is to provide an inode of putting the third parties concerned to express notice of the pledge. Subject to the pledgor's rights, only a party with express notice of the pledge created by the 'beneficial owner', following the manner prescribed for the creation of a pledge, deals with the securities at his own risk. This safeguards innocent third parties who would otherwise have no means of being aware of the pledge in case of dematerialised shares. The provisions of the Depositories Act, and in particular Section 12 thereof, and the 1996 Regulations, and in particular Regulation 58, are salutary as they introduced

transparency and certainty in the securities market. There is no other discernible reason for the legislature to have provided for a particular manner alone for creating a pledge of shares in a dematerialised form. More significant for our purpose are the observations, with which we again agree, that the prescription in the Depositories Act and the 1996 Regulations are for the manner in which creation and transfer of the dematerialised shares can be achieved. It is to regulate the creation and transfer of dematerialised securities, including how the pledge can be transferred to a third party. The Contract Act does not stipulate that a pledge can be created only in a particular manner. The Depositories Act prescribes how the dematerialised securities can be pledged. The provisions of the Depositories Act and the 1996 Regulations are not in derogation of the Contract Act but in addition to it. In this regard, reference is made to Section 28 of the Depositories Act, which we have referred to earlier. Therefore, the object of the Depositories Act is not to rewrite the provisions of the Contract Act but to regulate the creation and transfer of dematerialised securities. Regulation 38(1)(e)[78] requires a

78 38. Records to be maintained. (1) Every depository shall maintain the following records and documents, namely :—
(a) records of securities dematerialised and rematerialised;
(b) the names of the transferor, transferee, and the dates of transfer of securities;
(c) a register and an index of beneficial owners;
(cc) details of the holding of the securities of beneficial owners as at the end of each day;
(d) records of instructions received from and sent to participants, issuers, issuers' agents and beneficial owners;

depository to maintain, *inter alia*, records of all approvals, notices and entries, and cancellation of pledge or hypothecation, as the case may be.

11.3 We have already referred to the judgment of the Allahabad High Court in ***Firm Thakur Das Marakhan Lal*** (supra) and the view expressed by Justice Story on the Law of Bailment. On the identical issue, there is another decision, which was noticed by Chagla, J. in ***Madholal Sindhu*** (supra), in the case of ***Donald*** v. ***Suckling,***[79] wherein 'A' had deposited debentures with 'B' as security for payment of a bill endorsed by 'A' and discounted by 'B'. Before the maturity of the bill, 'B' deposited the debentures with 'C' to be kept by him as a security until the repayment of the loan from 'C' to 'B' for an amount larger than the bill. The bill was dishonoured and while it was still unpaid, 'A' brought detinue action against 'C' for debentures. The Court held that the repledge by 'B' to 'C' did not put an end to the contract of pledge between 'A' and 'B', and that 'A' could not maintain detinue action without

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(e) records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be;
(f) details of participants;
(g) details of securities declared to be eligible for dematerialisation in the depository;
and
(h) such other records as may be specified by the Board for carrying on the activities as a depository.
(2) Every depository shall intimate the Board the place where the records and documents are maintained.
(3) Subject to the provisions of any other law the depository shall preserve records and documents for a minimum period of five years.

79 (1866) L.R. 1 Q.B. 585.

having paid or tendered the amount of the bill. One of the Judges in the judgment had observed:

> "and I think that, although he (pledgee) cannot confer upon any third person a better title or a greater interest than he possesses, yet, if nevertheless he does pledge the goods to a third person for a greater interest than he possesses, such an act does not annihilate the contract of pledge between himself and the pawnor; but that the transaction is simply inoperative as against the original pawnor, who upon tender of the sum secured immediately becomes entitled to the possession of the goods, and can recover in an action for any special damage which he may have sustained by reason of the act of the pawnee in repledging the goods.
>
> xx xx xx

Another Judge had observed:

> "In detinue the plaintiff's claim is based upon his right to have the chattel itself delivered to him; and if there still remain in Simpson, or in the defendant as his assignee, any interest in the goods, or any right of detention inconsistent with this right in the plaintiff, the plaintiff must fail in detinue, though he may be entitled to maintain an action of tort against Simpson or the defendant for the damage, if any, sustained by him in consequence of their unauthorized dealing with the debentures."

We should not be seen as commenting upon the merits of the decision in ***Pushpanjali Tie Up Pvt. Ltd.*** (supra), as one of the findings recorded therein was that the pawnor had permitted the pawnee to repledge the pawn for a higher amount. The aspect, whether this can be permitted and allowed, and whether the interpretation of the relevant clause of the document of pledge

in ***Pushpanjali Tie Up Pvt. Ltd.*** (supra) is correct, are not examined by us and are left open.

11.4 Our attention was also drawn to a Single Judge Bench judgment of the Delhi High Court in ***Tendril Financial Services Pvt. Ltd. & Ors.*** v. ***Namedi Leasing & Finance Ltd. and Ors***.,[80] which supports the MHPL's case. However, a careful reading of the judgment would show that it was passed in peculiar facts therein as there was an *ad interim* order which had remained in force for twelve years, consequent to which the pawnee was unable to sell the shares. We agree that normally a court would not grant interim injunction on the prayer of the pawnor alleging non-compliance of Section 176 of the Contract Act. The object and purpose requiring the pawnee to issue notice to the pawnor before selling the pawn is to give an opportunity to the pawnor to redeem the pledged goods before the 'actual sale'. The requirement of issue of reasonable notice under Section 176 would be satisfied once the pawnor is made aware and has knowledge of the pawnee's desire/intent to sell. Continuation of interim orders predicated on the ground of lack of reasonable notice under Section 176 would not be a justification when the pawnee in his written statement clarifies and takes a clear position. The written statement itself can

80 2018 SCC OnLine Del 8142

be treated as reasonable notice. We have made these observations as we have come across cases where such injunctions have been granted and confirmed even after the pawnee has entered appearance.[81]

11.5 On other aspects the judgment has placed reliance on ***JRY Investments Private Limited*** (supra) and made certain observations regarding Section 176 and Regulation 58 to hold that a notice under Section 176 would be in derogation of Regulation 58 by giving the following reasoning:

> "21. I have considered the controversy and for the reasons following, am of the view that the plaintiffs are not entitled to the continuation of the ad interim order which has remained in force for the last 12 years:
>
> xx xx xx
>
> E. I may however add, that a notice under Section 176 of Contract Act is in derogation of Regulation 58 supra. While Section 176 entitles the pledgee/pawnee to, on default by the pledgor/pawnor, sell the thing pledged, "on giving the pawnor reasonable notice of the sale", Regulation 58(8) entitles the pledgee to, "subject to the provisions of the pledge document", "invoke the pledge" and mandates the depository to "on such invocation" i.e. by the pledgee, "register the pledgee as beneficial owner of such securities" i.e. the securities pledged and further mandates the depository to "amend its records accordingly". There is no place for a prior notice under Section 176, in the scheme of Regulation 58(8). On the contrary, Regulation 58(9) requires the depository to, after so amending its records under Regulation 58(8), inform the participants of the pledgor and the pledgee of the

81 However, cases praying for an injunction on the plea that the full/part amount of debt has been paid or the event of default etc. has not occurred would have to be examined on their facts. See, *infra* para 11.7.

same and mandates the said participants to inform the pledgor and the pledgee. Thus, (a) while Section 176 provides for a notice to pledgor prior to effecting sale, Regulation 58 provides for notice post invocation and on which invocation beneficial ownership of pledged shares changes from that of the pledgor to that of the pledgee and which is equivalent to sale under Section 176. To hold that a prior notice under Section 176 of Contract Act is also required in the case of pledge of dematerialized shares would interfere with transparency and certainty in the securities market, rendering fatal blow to the Depositories Act and Regulations and the object of enactment thereof.

F. The distinction sought to be drawn by the senior counsel for the plaintiffs between “invocation” and “sale” is also not in consonance with Regulation 58. I may notice that there is no such distinction in Contract Act either. While Section 176 of Contract Act entitles pledgee to, on default of pledgor, sell the pledged thing i.e. transfer title and possession thereof to purchaser, Regulation 58 entitles the pledgee to, on default on pledgor, invoke the pledge by intimating to the depository and mandates the depository to in its records record the pledgee in place of the pledgor as the beneficial owner of pledged shares, thereby transferring title as beneficial owner, from the pledgor to pledgee. The only condition imposed on invocation of pledge by the pledgee, under Regulation 58 (8) is of the same being required to be “subject to the provisions of the pledge documents” i.e. of creation of pledge in the manner provided in Regulation 58(1) to 58(6)-of which the participant of the pledgee and the depository have been made aware and with which they are thereby required to comply with. It is not the case of plaintiffs that there was any condition of prior notice in the pledge documents. Though it is not the plea that the Letters of Pledge and Arbitral Award were intimated to the participant or the depository but even they do not provide for prior notice. On the contrary, they provide otherwise. The distinction drawn in the Letters of Pledge aforequoted between invocation of pledge, whereupon the beneficial ownership in pledged shares, under Regulation 58, was to stand transferred from that of pledgor to that of pledgee, and sale of said shares by pledgee, to realize its dues, is only for the purpose of determining the amount which

> was to be offset from the debt to secure which the pledge was made. However such agreement cannot be interpreted as the pledgor continuing to have title in the shares. The only title in dematerialized shares, under the Depositories Act, is as beneficial owner in the records of the participant and the depository and which beneficial ownership changes on invocation of pledge in terms of Regulation 58. Even otherwise, a plea of a pledgor, of the pledgee, though after notice under Section 176, having sold the pledged thing for less than optimum price cannot be a ground for invalidating the sale. The mere fact that the parties, in terms of Arbitral Award reversed the earlier invocation also cannot change the said position. Such agreement is also not found to be inconsistent with Regulation 58. The quantum of consideration does not affect the transfer of title as beneficial owner."

11.6 In view of the discussion in the preceding paragraphs, we do not agree with the reasoning in the aforesaid sub-paragraphs and consequent *ratio decidendi* in ***Tendril Financial Services*** (supra). We do not find any derogation or conflict between Section 176 of the Contract Act and sub-regulations (8) and (9) of Regulation 58. Regulation 58(8) entitles the pawnee to record himself as a 'beneficial owner' in place of the pawnor. This does not result in an 'actual sale'. The pawnee does not receive any money from such registration which he can adjust against the debt due. The pledge creates special rights including the right to sell the pawn to a third party and adjust the sale proceeds towards the debt in terms of Section 176 of the Contract Act. The reasoning that prior notice under Section 176 of the Contract Act would interfere with transparency and certainty in the securities market and render

fatal blow to the Depositories Act and the 1996 Regulations is farfetched as it fails to notice that the right of the pawnee is to realise money on sale of the security. The objective of the pledge is not to purchase the security. Purchase by self, as held above, is conversion and does not extinguish the pledge or right of the pawnor to redeem the pledge. Equally, it may be a disincentive for both the pawnor and the pawnee in many cases, if we accept this interpretation and ratio, which would inhibit them from entering into a transaction creating a pledge. Difficulties and disputes regarding price, valuation, right to redemption etc. could invariably arise. There would also be difficulties in case the dematerialised securities are not traded as in the present case. If the case pleaded by MHPL is to be accepted, the entire dues of PIFSL stand paid without in fact a single penny coming to the coffer of PIFSL. Whether or not PIFSL will be able to find a willing buyer and sell the shares is unknown given the fact that the shares are unlisted and MHPL continues to be the holding company of NEVPL. The effect of the ratio in ***Tendril Financial Services*** (supra) is to enact an entirely new jurisprudence on the law of pledge, annulling and re-writing the well-established law of pledge, which gives two options to the pawnee when pawnor is in default, just because the pawnee exercises his right to be recorded as the

'beneficial owner' to exercise his right to sell. Sale to self, if accepted as the norm, would be unlawful and amounts to conversion, is applicable in case of dematerialised securities.

11.7 In fact, in the subsequent paragraphs, the learned Single Judge in ***Tendril Financial Services*** (supra) does examine the position if Section 176 were to apply and had not been complied with. It is rightly observed that due to the pendency of the suit, the requirement of giving sufficient notice might not be relevant. The decision in ***Tendril Financial Services*** (supra) also notices another decision of the Single Judge Bench of the Delhi High Court in ***GTL Limited*** v. ***IFCI Ltd. & Ors.***[82] which takes a contrary view and holds that compliance with Section 176 is required to be made in respect of pledged dematerialized securities. In ***GTL Limited*** (supra) temporary injunction was granted. We have briefly commented that injunction should not be normally granted in such cases.[83] Clause (c) to sub-section (3) to Section 38[84] of the

82 2011 SCC OnLine Del 3628.

83 *Supra* para 11.4.

84 Section 38. Perpetual injunctions when granted:

(3) When the defendant invades or threatens to invade the plaintiff's right to, or enjoyment of, property the court may grant a perpetual injunction in the following cases, namely:—

(*c*) where the invasion is such that compensation in money would not afford adequate relief;

Specific Relief Act, 1963 states that perpetual injunction may be granted when the defendant invades the plaintiff's right to or enjoyment of the property where the invasion is such that the compensation in money would not afford adequate relief. Sub-section (2) to Section 38[85] states that when any obligation arises from a contract, the court shall be guided by the rules and provisions contained in Chapter II.[86] Section 10,[87] as it stood before its substitution by Act 18 of 2018, *vide* clause (ii) of Explanation, had stated that until and unless contrary is proved, the court shall presume that the breach of a contract to transfer movable property can be relieved except in cases: (a) where the property is not an ordinary article of commerce, of special value or interest to the plaintiff, or consists of goods which are not easily obtainable in the market; and under clause (b) where the property

85 Section 38(2): When any such obligation arises from contract, the court shall be guided by the rules and provisions contained in Chapter II.

86 Chapter II: Specific Performance of Contract

87 Section 10. Cases in which specific performance of contract enforceable.—
Except as otherwise provided in this Chapter, the specific performance of any contract may, in the discretion of the court, be enforced—
(a) when there exists no standard for ascertaining actual damage caused by the non-performance of the act agreed to be done; or
(b) when the act agreed to be done is such that compensation in money for its non-performance would not afford adequate relief.
Explanation.—Unless and until the contrary is proved, the court shall presume—
(i) that the breach of a contract to transfer immovable property cannot be adequately relieved by compensation in money; and
(ii) that the breach of a contract to transfer movable property can be so relieved except in the following cases:—
(a) where the property is not an ordinary article of commerce, or is of special value or interest to the plaintiff, or consists of goods which are not easily obtainable in the market;
(b) where the property is held by the defendant as the agent or trustee of the plaintiff.

is held by the defendant as the agent or trustee of the plaintiff.[88] As per new Section 10[89] with effect from 1st January 2018, specific performance of a contract can be enforced subject to provisions contained in sub-section (2) to Section 11,[90] Section 14[91] and Section 16.[92] Clause (c) to Section 16 states that specific performance of a contract cannot be enforced in favour of a person who fails to prove that he has performed or has always been ready and willing to perform the essential terms of the contract which are to be performed by him, other than the terms the performance of which has been prevented or waived by the defendant. Explanation which applies to clause (c) states where a

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88 A pawnee is a trustee but has a special right to sell the pawned property after giving reasonable notice of sale to the pawnor.

89 Section 10. Specific performance in respect of contracts.—The specific performance of a contract shall be enforced by the court subject to the provisions contained in sub-section (2) of Section 11, Section 14 and Section 16.

90 Section 11. Cases in which specific performance of contracts connected with trusts enforceable.

91 Section 14. Contracts not specifically enforceable.

92 Section 16. Personal bars to relief: Specific performance of a contract cannot be enforced in favour of a person—
(a) who has obtained substituted performance of contract under Section 20; or
(b) who has become incapable of performing, or violates any essential term of, the contract that on his part remains to be performed, or acts in fraud of the contract, or wilfully acts at variance with, or in subversion of, the relation intended to be established by the contract; or
(c) who fails to prove that he has performed or has always been ready and willing to perform the essential terms of the contract which are to be performed by him, other than terms the performance of which has been prevented or waived by the defendant.
Explanation.—For the purposes of clause (c),—

(i) where a contract involves the payment of money, it is not essential for the plaintiff to actually tender to the defendant or to deposit in court any money except when so directed by the court;
(ii) the plaintiff must prove aver performance of, or readiness and willingness to perform, the contract according to its true construction.

contract involves payment of money, it is not essential that the plaintiff should actually tender to the defendant or deposit in court any money except when so directed by the court. However, the plaintiff must prove performance of, or readiness and willingness to perform, the contract as per its true construction. These aspects must be kept in mind by the court while examining the question of grant of injunction, *albeit* the fundamental principles relating to law of pledge being the special law should be applied as the plaintiff has to establish a *prima facie* case, balance of convenience and irreparable harm. These aspects on most occasions would be fact and situation specific.

11.8 Our attention was drawn to the decision of the Securities Appellate Tribunal, Mumbai, in the case of ***Liquid Holdings Private Limited*** v. ***The Securities Exchange Board of India.***[93] In this case, on exercising his rights, the pawnee was registered as a 'beneficial owner', but pursuant to a settlement, the pawnor was re-recorded as the 'beneficial owner'. The Board had claimed and succeeded in establishing that there was a transfer of the dematerialised securities resulting in violation of Regulation 7 and 11(1) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. This

93 (2011) SCC Online SAT 40.

decision, we may note, primarily deals with the takeover regulations and in the passing refers to and interprets Regulation 58 of the 1996 Regulations. The judgment is in the context of the takeover regulations and the legal violation thereof and on the issue whether change in 'beneficial ownership' would trigger the takeover regulations. The provisions of the Contract Act and the law of pledge have not been noted and examined. The appeal preferred was dismissed by a non-reasoned order. This decision, therefore, would not help us decide the issue in controversy. We, however, do observe that in view of our findings and reasoning, the Board may re-examine the 1996 Regulations as well as the takeover regulations to avoid discord or ambiguity resulting in instability or confusion. Clarity is necessary. The takeover regulations may have its own impact and in a given case, may be a detriment and a negative factor for the creditor who wants to secure himself by a deed of pledge. The pertinent question is, should takeover regulations apply when the pawnee exercises his right to be recorded as a 'beneficial owner', while reserving his right to sell the pledge. There would be tax and accounting implications which may be detrimental and shackle financial market and deals. It may inhibit financial institutions from accepting dematerialized securities as a pawn. A holistic review of

the impact of pledge *viz.* dematerialized securities, registration of the pawnee as the 'beneficial owner' without the pawnee enforcing the right to sell the pledge goods is required and necessary for the smooth functioning of the securities market and free flow of transactions without hindrance and to avoid uncertainty in fiscal matters.

G. Analysis of facts and application of law of pledge to the facts of this case

12.1 The relevant Clauses of the Pledge Deed dated 10th March, 2014 are reproduced as under:

> **"6.1 Registration in the Name of the Bridge Loan Lender:**
> The pledgor agrees that, upon the receipt of a notice of occurrence of Event of Default issued by the Bridge Loan Lender, the Bridge Loan Lender shall have the right to have the Pledged Shared transferred in its name or its nominees."
>
> **6.2 Enforceability and Sale:**
> Upon occurrence of an Event of Default, the Bridge Loan Lender or its nominee may without further authority and without prejudice to their other rights under applicable law but after giving notice to the Pledgor 5 (five) days' notice (which period of notice the Pledgor agree is reasonable notice) sell or otherwise dispose off all or any part of the Pledged Shares in such manner and for such consideration as the Bridge Loan Lender may in its sole judgment deem fit (whether by private sale or otherwise) and apply the net proceeds of any such sale or disposition in accordance with section 11 thereof."

12.2 As per Clause 6.1, on receipt of the notice of the occurrence of 'event of default' by the pledgor/pawnor, the pledgee/pawnee has the right to have the pledged shares transferred in its name or its

nominees. Under Clause 6.2, the pawnee or its nominee may, without further authority and prejudice to their other rights under the law, but on giving five days' notice to the pawnor, sell or otherwise dispose of any or all of the pledged shares in such manner and for such consideration as it in its sole discretion deems fit. The net proceeds of such sale or disposition are then applied in the manner prescribed under Clause 11 of the Pledge Deed.[94] Clause 14.1[95] clarifies that the Pledge Deed shall terminate only upon the repayment in full of the outstanding debt to the lender.

12.3 In the context of the present case, the contract of pledge envisages that PIFSL is entitled to get itself recorded as 'beneficial owner' without forfeiting its right in terms of Clause 6.2 to sell the shares. The contention of MHPL that Clauses 6.1 and 6.2 are in the alternative and once PIFSL has exercised option under Clause 6.1, the option under Clause 6.2 is closed must be rejected as

94 11. APPROPRIATIONS OF PAYMENTS:
All monies, sums, distributions, and monetary accretions received or recovered by the Bridge Loan Lender under or pursuant to this Deed of Pledge shall be applied, and appropriated in accordance with the Transaction Documents. Any surplus of such monies following payment of the Amounts Outstanding in full, held by the Bridge Loan Lender shall until such surplus amounts are paid to the Pledgor, be held in trust for the benefit of the Pledgor.

95 14. RELEASE AND TERMINATION:
14.1 This Deed of Pledge shall terminate upon the repayment in full of the Amounts Outstanding or upon a sale, transfer or other disposition of all the Pledged Shares in accordance with the terms of this Deed of Pledge.
14.2 Upon termination of this Deed of Pledge, following the repayment in full of the Amounts Outstanding, the Bridge Loan Lender shall, at the Pledgor's cost and expense, release the Pledged Shares from the pledge created under this Deed of Pledge and intimate the Pledgor of such release, other than such of the Pledged Shares that may have been sold or disposed off (sic.).

absolutely untannable. We do not find any such condition in the two clauses. As noticed above, PIFSL could not have exercised the right under Clause 6.2 unless the pledge shares were registered in its name as ‘beneficial owner’. This step was necessary to enable PIFSL to exercise its right and enforce the sale of pledge shares. Whether or not it would be successful in selling the pledge shares is unknown and uncertain even today. The amount of money that would be received is also unknown and uncertain.

12.4 Clauses 6.1 and 6.2, therefore, draw a clear distinction between a mere transfer of the pledged shares in the name of the pawnee or its nominee as a ‘beneficial owner’ and the ‘actual sale’ of the pledged shares. The right to sell is without prejudice to any other right under the applicable law. Thus, there are two stages before the pledge can be enforced by a sale. At the first stage, the pawnee must give notice to the pawnor under Clause 6.1 to exercise the rights to have the pledge shares transferred in its name or its nominees. This does not result in the discharge of the debt equal to the value of the shares. The discharge of debt in whole or part occurs when the pawnee exercises his right to sell the shares after giving five days’ notice to the pawnor in accordance with Clause 6.2 and sells the pawn. Upon the actual

sale, the pawnee can apply the net proceeds of the sale or disposition in accordance with Clause 11 of the Pledge Deed.

12.5 As discussed above, Clause 6.1 permits PIFSL to get itself recorded as a 'beneficial owner' of the shares pledged, a mandate and a requirement to enable PIFSL as a pawnee to sell the shares pledged. Clause 6.2 is for the sale of the said shares, and in this regard, we must refer to sub-clauses (k) and (m) of Clause 5.1 of the Pledge Deed, which read thus:

> "**5.1 The Pledgor's Undertakings**:
> The Pledgor assures, undertakes and agrees with the Bridge Loan Lender that throughout the continuance of the pledge created pursuant to this Pledge Deed and until the repayment of the Amounts Outstanding in full under the Transaction Documents, the Pledgor:-
>
> xx xx xx
>
> (k) hereby irrevocably waives any right it may have under the Depositories Act, the Depositories Regulations or any other applicable law to the extent the same is inconsistent with the undertakings as aforesaid and the pledge of the Pledged Shares pursuant to this Pledge Deed;
>
> xx xx xx
>
> (m) remain the sole beneficial owner at all times of the Pledged Shares except on a sale by the Bridge Loan Lender of the Pledged Shares."

As per Clause 5.1(m), the pawnor agrees that throughout the continuance of the pledge created pursuant to the pledge deed and until the repayment of the amount outstanding in full

under the transaction document, that is, the Bridge Loan Agreement, the pawnor shall remain the beneficial owner of the shares pledged at all times, except on the sale made by the pawnee as the bridge loan lender. Further, *vide* Clause 5.1(k), the pawnor has irrevocably waived any right it may have under the Depositories Act, the 1996 Regulations, or any other applicable law to the extent it is inconsistent with the provisions of the Pledge Deed. Clause 5.1(k) would only apply if the Depositories Act, the 1996 Regulations, or any other law permits the parties to contract out of the regulations by mutual agreement. It is a settled position of law and as discussed above, a contract cannot be inconsistent with the provisions of any existing law, including regulations, unless the said law permits the parties to enter into a contract inconsistent with the provision.

12.6 PIFSL by the letter dated 23rd January 2018 had informed MHPL in terms of Clause 6.1 that there has been an occurrence of default, which has continued and, therefore, they, on 16th January 2018, in exercise of its right under Clause 6.1 of the pledge deed, have applied for transfer of the pledged shares in its name. Consequently, all the rights in the pledged shares, including but not limited to the right of attending general body meetings, voting rights, and rights to receive dividends and other distributions, now

vests with them as per Clause 2.3(A)(ii)(b)[96] of the pledge deed. This intimation to MHPL is without prejudice to any rights or remedies PIFSL has in terms of the pledge deed or security documents executed in pursuance of the bridge loan agreement. PIFSL expressly reserved its right to transfer and sell pawned shares for value providing five days' notice as required under Clause 6.2 of the pledge deed and Section 176 of the Contract Act. We would, without hesitation, therefore hold that on becoming the 'beneficial owner' in the records of the 'depository', the pawnee had complied with the procedural requirement of Regulation 58(8) to enforce the right to sell the shares. Thereafter, such a sale should be made according to Sections 176 and 177 of the Contract Act. Violation of the said provisions, if made by PIFSL, would have its consequences as per the law. Pawn has not been sold and there is no violation of the Contract Act or for

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96 2.3. Voting rights and dividends

(A) So long as no event of default or potential event of default has occurred and is continuing, subject to the provisions of the Transaction Documents:

(ii) the Pledgor shall be entitled to receive and retain any and all dividends and other distributions paid in respect of the Pledged Shares only with prior written approval of Bridge Loan Lender, provided, however, that any and all:

(b) dividends and other distributions paid or payable in cash in respect of or in con`nection with any liquidation or dissolution or in connection with a reduction of capital;

that matter the Depositories Act and the 1996 Regulations. PIFSL has not overlooked its obligations under Sections 176 and 177 of the Contract Act by relying upon sub-regulation (8) to Regulation 58, which has an entirely different object and purpose. Recording change in the register of the 'depository', whereby PIFSL as the pawnee has become the 'beneficial owner', is only to enable the pawnee to sell and transfer the shares in accordance with the Depositories Act and the 1996 Regulations. The object and purpose of sub-regulation (8) to Regulation 58 is not to nullify the obligation of MHPL i.e., the pawnor, and PIFSL i.e., the pawnee, under the Contract Act but to enable PIFSL to exercise its rights under Section 176. It also follows that MHPL is entitled to redeem the pledge before the sale to a third party is made.

12.7 In view of the aforesaid findings, it has to be held that registration of the pawn, that is the dematerialised shares, in favour of PIFSL as the 'beneficial owner' does not have the effect of sale of shares by the pawnee. The pledge has not been discharged or satisfied either in full or in part. PIFSL is not required to account for any sale proceeds which are to be applied to the debt on the 'actual sale'. The two options available to PIFSL as the pawnee under Section 176 of the Contract Act remain and are not exhausted.

H. Conclusion

13.1 For the aforesaid reasons, the present appeal must be allowed and the impugned order passed by the Appellate Authority dated 20th June 2019 upholding the orders of the Adjudicating Authority dated 6th July 2018 and the emails of the IRP dated 19th February 2018 are set aside. It is held that MHPL is not a secured creditor of the Corporate Debtor, namely NNPIL, to the extent of the value of the 31,80,678 shares. PIFSL has rightly made a claim as financial creditor of the Corporate Debtor without accounting for the value of 31,80,678 shares of NEVPL in its claim petition. Insolvency proceedings against the Corporate Debtor, namely NNPIL, will proceed accordingly.

13.2 The appeal is allowed in the aforesaid terms without any order as to costs.

.....J.
(M.R. SHAH)

.....J.
(SANJIV KHANNA)

NEW DELHI;
MAY 12, 2022.