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# Pledge

The Indian Contract Act of 1872 is the act governing the formation and enforcement of contracts in India and its territories. The act lays down provisions regarding the essentials of the contract such as offer, acceptance, consideration etc. The Contract Act is both an amending as well as a consolidating act, and it is not exhaustive of the Law of Contract[1].

Pertinently, the Indian Contract Act, 1872 goes beyond the contracts of sale and purchase involving basic elements such as offer, acceptance and alike. The provisions of the Act also pertains to some special kinds of contract such as that of indemnity, guarantee, bailment and so on. These find mention from chapter VIII of the Act.

One such special kind of contract is the contract of pledge. Contract of pledge or simply pledge is a special kind of contract which is of great importance especially in economic transactions. Pledge in general words refers to placement of a good or its title as a security either for repayment of a loan borrowed from the creditor or as for discharging an obligation made under a promise. Pledge has been regarded in both India and common law of England as a type of bailment for both involves delivery and possession of goods. In spite of being similar there are differences and Contract of pledge is distinct in itself.

This distinctiveness of the Contract of pledge arises from its features. The Indian Contract Act Chapter discusses the Contract of Pledge elaborately under the head of chapter IX Of Bailment sub head- **Bailment of Pledges** the relevant sections pertaining to the study of this concept are section 172 to section 179.

This research paper is therefore aimed at discussing the concept of Contract of Pledge in elaborate detail by delving deep into theory and philosophy behind pledges, that how a Contract of pledge works, what are the rights and remedies of the parties under it and how the contract of pledge is distinct from the seemingly related concepts. The following research paper proceeds by first laying down briefly the meaning of a contract of pledge followed by mentioning its features which makes credits to its distinctiveness.

Also this research paper has embedded in it certain case laws for developing a comprehensive understanding of the actual application of the Contract of Pledge. Later sections of the paper includes distinctions between Pledge and other concepts such as hypothecation, mortgage, lien etc. The author would adopt the style of section by section analysis to elaborate on the issue.

## Pledge: Meaning, Definition And Nature

The Indian Contract Act 1872 defines the Contract of Pledge as:

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

From the definition of the term pledge in the given section, it is clear that pledge is also a type of bailment due to the fact that a contract of pledge to come into existence, delivery of goods is

requisite. A pledge can also be defined as , Pledge is the transfer by one person to another of the possession of certain goods to be held by the latter as security for the performance by the former of some obligation to pay or perform, which being performed, the pledge must be restored.[2] The Supreme Court has defined pledge as , Pawn or pledge is a bailment of personal property as a security for some debt or engagement. A pawnor is one who being liable to an engagement gives to the person to whom he is liable a thing to be held as security for payment of his debt or the fulfilment of his liability[3]

There are three categories in which security is provided, namely- lien, mortgage and the third of them is pledge.[4] Under a contract of pledge, any good or the title of the good is pledged by one party to the other as a collateral for the money advanced by the later party. Thus making of pledge is a condition precedent for advancing money. Pledge may also be defined as delivery of goods by the debtor to the creditor for a debt or for any other contractual obligation and the object herein delivered shall be returned to the pledgor when the debt money has been repaid or the obligation has been performed.[5]

A valid contract of pledge involves the bailment of goods, as defined under section 148[6] of the Act as security for the debt. There is no difference regarding the concept of pledge in both Indian and Common Law system of England. The nature of the contract is one of security where this security is liable in case of default by the debtor.

## Essentials Of Pledge

1. **Delivery of the good to be pledged-** to constitute a valid contract of pledge, the primary requirement is the delivery of the possession of a good. There must be an actual delivery of possession of the identified chattel in pursuance of the contract.[7] The property or any other good pledged must be actually and constructively delivered to the creditor which in this case is the pawnee, the person to whom pledge has been made.

Actual delivery refers to the physical delivery of the good to the pawnee, the whole of the good is bailed to him. On the other hand pledge by way of constructive delivery involves an indirect or symbolic delivery of the property or the good. The most common illustration on this point is the delivery of the key of the warehouse containing the goods to be pledged to the pawnee. Delivery can also be made by the way of attornment[8] which means that if the goods are in possession of a third person, the pledgor may give him direction to hold them on pledgees behalf. Also delivery of the title of the good or property to be pledged would constitute an equivalent of actual delivery for the purpose of pledge. In a Supreme Court case, Subba Rao J held that the railway receipts for goods was the same thing as delivery of goods and that pledge entered thereby was valid and the pledgee was invested with the rights.[9]

Thus what can be inferred is that the goods pledged need not actually change hands, there can be a valid contract of pledge in spite of the good still remaining in the possession of the pawnor.

2. **A valid contract-** though contract of pledge comes under the head of Special contracts yet it is necessary that for it to be valid, there must be contract with all the essentials as mentioned in the provisions of the Indian Contract Act 1872.
3. **Right on the Pledge-** another major ingredient of pledge is that the pawnee merely possess possessory rights and not juristic rights over the pledge. The pawnee only has the special

property while the general property stays with the pledgor. When the pledge comes to an end by way of repayment the special rights are also transferred back to the pledgor.[10]

4. **Time of Delivery-** Under a contract of pledge the delivery of possession and the payment of money need not always be simultaneous. A pledge can even be given subsequently after advance has been made.[11] A case in hand on this issue to elaborate further is *Blundell Leigh v Attenborough*[12].

The facts of the case are that A gave B some jewels for the purpose of valuation and to let her know as to what credit can she secure on their value. B kept the jewel as security if he did make advances to her. This was on November 1st. that same day B took the jewels and pledged them with C for 1000 pounds. On a later date B made advance of 500 pounds to A on the pledge of the jewels and promissory note.

Subsequently A died. B then sued C for recovery of jewels stating that the jewels which she gave to A was only a gratuitous bailment and he was not entitled to do anything with them. When he subsequently advanced money it was not a pledge as he was not in the possession of the goods. When the matter went to the court, the trial court held that there was no valid pledge between A and B as the jewels were not in the possession of B at the time of pledge being made.

Therefore A was entitled to get back the jewels from C without any payment of money of any kind. However this decision was reversed by the Court of Appeals which held that the original delivery, though a gratuitous one, constituted a good and valid delivery. Thus even though he was not in the possession of the jewels at the time of making the pledge, it was still valid.[13]

## Rights Of The Pawnee Under Contract Of Pledge

The pawnee or the pledgee under a contract of pledge gets no absolute title at law he is a mere possessor of the property or good pledged to him. This is known as Special Property. In this kind of property, the ownership rights including rights of its enjoyment remains with the pledgor while what is actually transferred is only possession.

However, the pawnee does have one right in this situation, namely the right to sale the thing pledged in case of default by the debtor. But this is not the only right which the pawnee under pledge is entitled to. The following sections deals with the rights of the pawnee as has been provided under the Indian Contract Act 1872.

1. Right to retain- until and unless the loan has been repaid or the obligation has been performed, the pawnee has the right to retain the goods. This is illustrated in section 173 of the Indian Contract Act 1872,

173. Pawnees right of retainer.-The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interests of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Thus a pawnee can retain the goods for-

- a) payment of the debt or performance of the promise,
- b) interests on the debt,
- c) all other expenses incurred by him in respect of the pledged goods.[14]

The pawnee can hold or retain the goods only for the payment of that debt for which the particular goods have been pledged. Unless a pledgee's claim under pledge has not been satisfied, another creditor can not take away the pledged goods from his possession. A case here in point is *Bank of Bihar v State of Bihar*[15] where the pledgee bank advanced loan to the pledgor on the pledge of sugar bags whose constructive delivery was made by handing over of the key of the godown where these were stored. However these were then seized by the state of Bihar through rationing officer and district magistrate. Thereafter the pledgee, the Bank, filed a suit for the recovery of the sugar bags. It was held that the act of the State of seizing the goods will not deprive the pledgee of his rights of the pledge and that he was still liable to the amount he advanced.

Thus the State had the responsibility to indemnify him. The Bank had the special property right over the sugar bags which will not extinguish until the debt amount has been paid back to him. Thus the State had to reimburse the bank after realising the sale of the pledged goods on default of pawnor in making repayment of the debt.

2. Right to retain for subsequent advances- section 174 provides that the pawnee is not entitled to retain the goods for debt or promise other than that for which goods were pledged for.[16] However it is presumed that the pawnee has the right, if he makes subsequent advances to the pawnor, to retain the goods unless it is otherwise provided in the contract. Thus it is the terms of the contracts which decides the rights of the pawnee in this case.
3. Right to extraordinary expenses- the pawnee has further rights of claiming from the pledgor extraordinary expenses as provided under section 175, 175. Pawnee's right as to extraordinary expenses incurred.-The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.

This includes the expenses which the pledgee has incurred by virtue of preserving the goods under his possession by way of pledge. The pertinent thing to note here is the usage of the word receive which states the position that the pledgee cannot retain the goods for the extraordinary expenses. In other words it can be said that his lien over the pledged goods does not extend to cover the rights of extraordinary expenses. Thus what the pledgee has is the right of action for recovering these expenses.[17]

4. Pledgee's rights in case of default- the pawnee is entitled to the exercise of this right when there is a default from the side of the pawnor or the debtor.

**The pawnee's rights are contained in section 176 of the act which reads as follows:**

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 such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor.

Thus section 176 vests in the pawnee two distinct rights in case of default namely:

1. To sue the pawnor upon the debt and retain the goods or collateral as security and
2. To sell the thing which has been pledged after a proper notice of such a sale has been transmitted to the pawnor.

A pawnee has to right to sell the thing pledged and this right is exercisable after notice off intent of sale and thereafter the pawnee is entitled to sell the thing on any time of his will.[18] The later part of the section further states that if after sale the amount received is less than the debt then the pawnor would still be liable and when the proceeds received after sale is higher than the amount to be paid under debt then it is the duty of the pawnee that he pays the surplus back to the pawnor. After the sale the right of the pawnor of re-delivery is extinguished but his right to redeem continues up to sale.[19]

Requirement of Notice- section 176 requires that if the pawnee is to exercise his right of sale then he must do so after he makes a notice of the same to the pawnor.[20] Making of the notice is a statutory obligation and thus even though it is mentioned in the terms of contract that notice is not necessary, still the pawnee is obligated to make a notice. A notice of sale must be given in all cases of pledge even when an instrument of pledge contains unconditional power of sale.[21]

As to from and manner of the notice, there has been no statutory compulsion.[22] However the language of the notice must not be such that it acquires character of an implied notice. It must be clear and specific of the intentions of selling the goods.[23] It is not necessary on the part of the pawnee to specify the details of the sale in the notice and even when he has mentioned the specific, he is under no obligation to abide by it. If in case of a pledge where no time for repayment has been specified then a right to sell may arise when a notice has been served by the pawnee regarding clearing the dues within specified time.

The pawnee also has the right to bring a suit against the pawnor for the recovery of the amount advanced by him. Thus the choice of right the pawnee wants to exercise is his discretion.[24]

## Pawnors Right To Redeem

The right to redeem as provided under section 177[25] of the act must be read along with the earlier sections. The pawnor is entitled to redeem the goods at any time before the pawnee has exercised his right to sell them. This right is exercisable even when the period specified for repayment has come to an end. To exercise this right, a suit for redemption has to be filed.[26] Even if the pawnor prematurely redeems his good, before expiration of specified time, the terms of the loan would still persist.[27]

## Pledge By The Mercantile Agent

Section 178 provides that a pledge made by a mercantile agent, acting in the ordinary course of business is valid. It reads as, 178. Pledge by mercantile agent.-Where a mercantile agent is, with the consent of the owner, in possession of goods or the document of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has not authority to pledge.

**Explanation:** In this section, the expressions mercantile agent and documents of title shall have the meanings assigned to them in the Indian Sale of Goods Act, 1930 (3 of 1930).]

Consent of the owner of the goods is assumed to exist in case where the mercantile agent pledges a good. A mercantile agent is one who has the authority on behalf of the owner to sell, consign or raise money out of the goods by keeping them as security.[28]

The present section 178 came into force after the earlier wordings of it were repealed in 1930. In the earlier section any person in possession of goods or documents of that good can effect a pledge but

after the new section has been enacted this right of pledging on behalf of goods whose ownership rests with another is only given to a mercantile agent.[29] This section has been enacted with an objective to protect those dealing in good faith with persons who are mercantile agents.[30] The new section is an improvement in another sense that it provides that those in possession and not in mere custody are entitled to make pledge the goods owned by a third party.

## Pledge Under Voidable Contract

This type of pledge has been provided under section 178A of the Act which states that even when the pawnor has obtained the goods under a voidable contract by the virtue of section 19 and 19A, and when the contract has not been rescinded at the time of pledge, the pawnee will acquire a good title to the pledged goods.

However it is required that the pawnee must act in good faith and must have been unaware of the presence of a voidable contract. The principle here is that though there is a de facto contract even if it is voidable due to the reason of fraud, misrepresentation and alike.[31] For instance if a person buys good without paying for them, there is consent, though not free and the contract in spite of being voidable will enable the party receiving the good to make a valid pledge.[32] Thus what matters here is the possession of the title of the goods to be pledged.

## Pledge When Pawnor Has Limited Interest

Under section 179[33], it is provided that a person is eligible to make pledge to the extent to which he has interest in it. Whenever a party to pledge has interest, he has unconditional authority to charge at least that interest.[34] While the cases where the pawnor has no interest and only possession are governed by section 178 and 178A of the Act, the cases where the pawnor has, even a limited interest, falls within the ambit of section 179.

## Pledge And Its Distinctiveness

1. Pledge and Hypothecation- a hypothecation has been regarded as a form of pledge[35] but where there is no delivery of the possession. Thus the hypothecator still remains in the possession of the goods with all his interest and rights to enjoyment of it intact. It is pertinent to note that in case of hypothecation, unlike pledge where the pledgee is in possession, the owner of the things as an agent of the hypothecatee. Thus delivery of possession is the primary point of distinction between pledge and hypothecation. However, alike pledge the hypothecatee under pledge to have the right to sue and even to sell the thing for recovering the loan amount. In hypothecation the position of the true owner becomes that of a bailee of goods acting for the bailor who in this case is hypothecatee.[36] In simpler words the distinctiveness can be made clear by saying that while pledge involves transfer of possession, hypothecation involves transfer of rights or interest, those too limited.
2. Pledge and Lien- While a pledge creates special property in the thing pledged, lien is merely a personal right which the party is entitled to exercise in case where payment is due. The difference between the two arises on the basis of the rights the party have. While a pledge permits the pledgee to retain, sue and even sell the property of good pledged, under lien only the right of retainment is provided. To some extent lien can be regarded as an inverse of hypothecation as where the former involves transfer of possession, the later requires transfer of rights.
3. Pledge and Mortgage- pledge involves transfer of possession of a thing in return for certain sum or as a security for fulfilling an obligation. A pledge gives pledgee special rights to the

pledgee that in case of default he has remedies available with him. However, under a mortgage, other than these special rights, the juristic rights or the legal rights are also transferred. That is to say that the right of enjoyment is not transferred in the case of pledge, but in case of mortgage, the mortgagee has the right of enjoyment.[37] Also another point of distinction here is that a contract of mortgage does not require actual delivery of the goods or the things. Further, while only moveable goods are pledged under a contract of pledge, mortgage can be of both, moveable as well as immoveable property.

## Conclusion

With the above study the researcher has tried to answer the research questions mentioned in the project. The study can be concluded by stating that it has dealt with and analysed what a contract of pledge means and what is the nature of it. The features of pledge along with various rights, duties and obligations it creates has also been dealt with in this research study. The rights which the pawnee possess, the duties which the pawnor has and other features of pledge has been explained with giving due considerations to the relevant case laws. In the later part of project the researcher has dealt with how pledge is different from lien, hypothecation and mortgage to clear the general doubts which arises.

Thus conclusively it can be said that the above research has been able to fulfil the aims and objectives which the researcher had in his mind to a relatively great extent.

## MCQs

1.

The person who during the contract of bailment deliver goods is called

- |                            |                         |
|----------------------------|-------------------------|
| <b>A.</b> Bailor           | <b>B.</b> Bailee        |
| <b>C.</b> Both (a) and (b) | <b>D.</b> None of above |

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2. The person to whom goods are delivered according Bailment is called

- |                            |                  |
|----------------------------|------------------|
| <b>A.</b> Bailor           | <b>B.</b> Bailee |
| <b>C.</b> Both (a) and (b) | <b>D.</b> None   |

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3. In Bailment, bailor is duty bound to disclose fault in goods bailed as provided in section

- |                                    |                                    |
|------------------------------------|------------------------------------|
| <b>A.</b> 148, of the Contract Act | <b>B.</b> 149, of the Contract Act |
|------------------------------------|------------------------------------|



**C.** 150, of the Contract Act

**D.** None of above

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4. A hires a carriage of B. The carriage is unsafe though B is not aware of it and A is injured

**A.** B is responsible to A for the injury

**B.** B is not responsible to A for the injury

**C.** No one is responsible to each other

**D.** None of above

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5. The bailment of goods as security for payment of debt or performance of a promise is called

**A.** Pledge

**B.** Special bailment

**C.** Both (a) and (b)

**D.** None of above