Procedure to invoke remedy for Bank and financial institution under SARFAESI Act, 2002

Mr. Ankush Dasoo Rathod
Deputy Manager (Legal)

1. Introduction:

In the present era the scope of banking is expanding. The individual, firms, companies,ports etc are requirements of loan from the Bank. The reason for the loan may differ from person to person and company to company. All Banks should function in accordance with the guidelines/norms issued by The Reserve Bank of India. Subject to the lending norms of Reserve Bank of India, the Banks and Financial Institutions sanction loans for different purposes. Though, the Banks and Financial Institutions can lend money even without security, normally, the Banks and Financial Institutions insist for security for the repayment of loan. The fixed assets, receivables etc. can be securities acceptable to the Banks and Financial Institutions for sanctioning the loans. The loan entitlements, the procedure for sanctioning the loan, the security issues etc., are exclusively governed by the guidelines/norms issued by the Reserve Bank of India. Again, loan, being an agreement or understanding between the Bank and the borrower, the general laws like Law of Contract, Transfer of Property Act, Specific Relief Act, Specific Performance etc., are applicable to all banking transactions depending upon the nature of transaction. The prime objective of Bank is to receive deposits and use those deposits efficiently so as to make money. The Banks will also render certain specific services on behalf of its customers. The Reserve Bank of India will issue guidelines and norms considering the policy of the Government too. Exercising control over flow of money from Banks and Financial Institutions, the Reserve Bank of India promotes the balanced growth.

When a borrower fails to repay the money to the Bank, what the Bank can do for recovering the loan is to file a civil suit earlier. We all know the issue of delay in rendering justice in traditional civil courts and with the inevitable delay, the Banks could not recover its dues effectively and it resulted in liquidity problems. Bank pays interest to the deposit holders; however, the Banks could not make money by using the deposits as the recovery gets delayed frequently. This led the government to appoint various committees for financial sector reforms. The concentration was on effective recovery by the Banks and Financial Institutions apart from other things. It may be interesting and worthwhile to examine how the laws of the land have undergone changes to suit the current requirement of the banking and finance industry to protect the money lent by them and the consequent financial exposure undertaken by them.

Historically, in India the remedy available to lenders has been to file an ordinary money suit for recovery against the defaulting borrower for the outstanding amounts or to file a summary suit as provided for under Order 37 of Code of Civil Procedure 1908. Both these options have been time consuming. Another option available to the lender was to apply for foreclosure of mortgage, where borrower or guarantor had provided security by way of mortgage, in respect of outstanding towards the lender. Foreclosure and money suits have proved to be a long drawn battle in the court, consuming several years in litigation, owing to the delay on account of various reasons. The Indian courts, lower courts as well as high courts, were saddled with cases filed by the domestic banks, foreign banks and financial institutions. The delay in the disposal of such cases was deplorable.

Therefore the need was felt for the speedy disposal of cases for recovery of Bank dues. The pre-eminent problem faced by Banks and Financial Institutions is that of increasing bad debts euphemized as Non-performing Assets (NPAs).

2. The Objects of the SARFAESI Act, 2002:

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 in short "SARFAESI Act" was enacted with the objective of regulating securitization and reconstruction of financial assets and enforcement of security interest created in favour of secured creditors.The Act provides for three alternative methods for recovery of NPAs: (a) securitisation; (b) asset reconstruction; and (c) enforcement of security without intervention of court.

3. Applicability of the SARFAESI Act, 2002:

The provision of the Act, 2002 is applicable only if the amount of the NPA loan account exceed Rupees One Lakhs; and NPA loan account is more than twenty percentage of the principal and interest. NPAs should be backed by securities charged to the banks by way of hypothecation, mortgage or assignment and the secured assets are not hit by the provision of the section 60 of the Code of Civil Procedure, 1908. The secured asset must not be a lien on any goods, money, or security given by or under the Indian Contract Act, 1872 or the Sales of Goods Act, 1930 or under any other law for the time being in force; a pledge of movable within the meaning of section 172 the Indian Contract Act, 1872; security in aircraft/shipping vessels under section 3 of the Merchant Shipping Act, 1958; conditional sale, hire purchase, or lease where no security interest has been created; right of unpaid seller under section 47 of the Sale of Goods Act, 1930; property exempted under section 60 of the Code of Civil Procedure, 1908; security interest of any financial asset not exceeding one lakh rupees; security interest in agricultural land; case in which amount is less than twenty percent of the principal amount and interest thereon[1].

4. Securitisation: Meaning.

The concept of securitisation has been adopted more recently from the American financial system and has been described as processing of acquiring financial asset and packaging the same for investments by several investors. The term 'securitisation' has not been defined as such, but has been used in certain rules, regulations and notifications. In the recently enacted the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (for short "the Securitisation Act") the term securitisation has been defined as "a mechanism for acquisition of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interests in such financial assets or otherwise"[2].

5. Reconstruction of the Financial Assets:

The second concept contemplated under the SARFAESI Act, 2002 is reconstruction of financial assets, defined as "assets reconstruction", which means acquisition by any securitization company or reconstruction company of any rights or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance[3].

The concept of 'financial assistance' denotes any loan or advance granted or any debentures or bonds subscribed or any guarantee given or letters of credit established or any other credit facility extended by any bank or financial institution[4].

Thus, asset can be acquired only:

a. for the purpose of realization of the financial assistance; and

b. when the borrower is in default;

but not otherwise.

6. Difference between RDDBFI Act, 1993 and SARFAESI Act, 2002:

The main difference between RDDBFI Act, 1993 and SARFAESI Act, 2002 is as follows:
6.1. The RDDBFI Act, 1993 enables the Bank to approach the Tribunals when the debt exceeds the prescribed limit i.e. Rupees Ten Lakhs.

6.2. Under RDDBFI Act, 1993, the Debt Recovery Tribunal will adjudicate the amount due and passes the final award.

6.3. The SAFAESI Act, 2002 provides a procedure wherein the bank or financial institution itself will adjudicate the debt. Only after adjudication by the bank or financial institution, the borrower is given right to prefer an appeal to the Tribunal under SARFAESI Act, 2002.

6.4. The Banks or Financial Institutions can invoke the provisions of SAFAESI Act, 2002 only in respect of secured assets and it should comes under the definition of NPA and the amount of due must exceed Rupees One Lakhs NPA loan account is more than twenty percentage of the principal and interest and not all loan.

In Garlon Polylab Industries Ltd. v. State Bank of India[5] it has been held by the Allahabad High Court that SARFAESI Act, 2002 being a special act overrides provisions of Recovery of Debts Due to Banks and Financial Acts, 1993 or any other Act of Parliament or State Legislature pertaining to the field it covers.

7. Procedure to initiate remedy under SARFAESI Act, 2002:

7.1 Resolution of disputes through Arbitration or reconciliation:

Where any disputes relating to securitization or reconstruction or non-payment of any amount due including interest arises amongst any or the parties, namely, the bank, or financial institution, or securitization company or reconstruction company or qualified institutional buyer, such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996, as if the parties to the dispute have consented in writing for determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly [6].

Under the SARFAESI Act, 2002, an exhaustive procedure has been laid down under the SARFAESI Act, 2002 along with rules defining the manner in which banks may exercise against the delinquent borrower to enforce the security interest in the asset.

7.2. Classification of account as Non-performing Asset (NPA):

Invocation of Act for enforcement of security is triggered by classification of the account as "Non-performing Asset" by the Banks and Financial Institutions referred to as the secured creditors. In terms of the present Reserve Bank of India guidelines, in case any amount, which is due and payable by the borrower and has not, been paid for more than ninety days, the said account can be classified as NPA. Further, the secured creditor can take over the management of the business of borrower, where substantial part of the business of the borrower is held as security for the debt. In case any financial asset has been financed by more than one secured creditor, the notice can be issued only with the consent of secured assets representing not less than three-fourth in value of the amount outstanding.

7.3. Power to take possession under section 13 of SARFAESI Act, 2002:

The procedure to take possession is as follows:

7.3.1. Upon classification of account of the secured creditor as non-performing asset, who defaults in the payment of secured debt or any installment thereof, the Bank or Financial Institution gives a prior notice to the defaulting borrower including the mortgagors and guarantors under section 13(2) calling upon them to pay the entire due amount within a period of sixty days[7].

7.3.2. The notice referred under section 13(2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower[8].

7.3.3. Under section 13(3A) the borrower who receives the notice under section 13(2), may make the representation or send his objections to the authorized officer of the bank within the said time limit.

7.3.4. The authorized officer of the bank/secured creditor shall consider such representation or objections and if after considering such representation or objection secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall within fifteen days from the date of its receipt of such representation or objection the reasons for non-acceptance it, to the borrower[9]. This enables the Bank to correct itself if it is wrong in the process of adjudication. Before this exercise is done and the borrower has been suitably replied to, the secured creditors cannot take possession of the secured asset and management of business of the borrower.

7.3.5. In case the payment is not made by the borrower in full within the stipulated 60 days time period mentioned in the notice under section 13(2), the secured creditor may take one or more recourse mentioned in under section 13(4) namely,

i. To take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for releasing the secured asset. When it comes to taking possession of the property, there are two things like taking symbolic possession and taking actual possession[10].

ii. To take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for releasing the secured asset[11].

iii. Appoint the manager, to manage the secured asset whose possession has been taken[12].

iii. Requiring money from any person who has acquired any of the secured assets from the borrower and from whom any money is due to the borrower, to pay to the secured creditor, by notice in writing[13].

7.3.6. If the secured creditor obtains the possession of the secured asset or take over the management under section 13(4), it shall vest in the transferee all rights in or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset[14].

7.3.7. The sale proceed shall, in the absence of any contract to the contrary, be held by the secured creditor in trust, to be applied, firstly, in the payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money received shall be paid to the person entitled thereto in accordance with his rights and interests[15].

7.3.8. If the borrower paid or tendered the dues with all costs, charges and expenses to the secured creditors then secured creditor shall not sold or transferred the secured asset[16].

7.3.9. If the dues are not fully satisfied from the sale proceeds of the secured assets, the secured creditor may file an application before the Debt Recovery Tribunal (DRT) having jurisdiction or competent court, as the case may be for the recovery of the balance amount from the borrower(s)/guarantor(s)[17].

7.4. Application for assistance:

Where the possession of any secured asset is required to be taken by the secured creditor or if secured asset is required to be sold or transferred by the secured creditor, the secured creditor may for the very same purpose request in writing to the jurisdictional Chief Metropolitan Magistrate or District Magistrate to take the possession thereof. Such Magistrate may thereupon take possession of such asset and forward the same to the secured creditor. And may use or cause to be use such force as may, in his opinion, be necessary[18].

In Apex Electricals Ltd. v ICICI Bank Ltd[19]it has been held by the Gujarat High Court, that the rights of the bank under sub section (1), (2), (3) and (4) of section 13 cannot be read as creating a lawless situation, but should and must be preserved by maintaining rule of law and not allowing the disturbances of law and order situation. And such rights of secured creditor cannot be read as giving authority or power to the secured creditor to apply force of muscle power for taking measure under section 13(4) of the Act, and for such situation where muscle power required secured creditor resort of the provisions of section 14 of the present Act.

7.5. Right to appeal:

Any person aggrieved on account of any measure taken under section 13(4) by the secured creditor may make an application, along with requisite fees, to the Debt Recovery Tribunal within forty five days from the date on which such measures has been taken[20]. If the Debt Recovery Tribunal, after examining the facts and circumstances of the case and evidence produced by the parties, comes to the conclusion that the measures under section 13(4) are in contravention of the provision of the Act, it may declare the same invalid and restore the possession of the secured asset to the borrower[21]. And if the Debt Recovery Tribunal finds the measures taken by the secured creditor under section 13(4) in conformity with the provision of this Act, it may allow the secured creditor to proceed with the measure taken by him[22]. Aforesaid application must be disposed off as expeditiously as possible within sixty days from the date of such application. However, it may extend such period for reasons to be recorded in writing, for four months from the date of the making of the application[23].

7.6. Remedy under section 17 of the SARFAESI Act, 2002 bars writ petition:

In V. Sriramulu v Karur Vyasa Bank Ltd[24] it has been held that proceeding under section 13(4) doest not perform any public duty and is not amenable to a writ petition of mandamus and the person aggrieved has the liberty to file an application under section 17 of the SARFAESI Act, 2002.

In Barak Valley Tea Co. v. Union of India[25] it has been held that any person aggrieved with an action under section 13(4), may invoke remedy under section 17 and this statutory remedy cannot be bypassed by invoking the writ petition.

7.7. Section 13 of the SARFAESI, Act 2002 overrides section 69 Transfer of Property Act, 1882:

At present, an attempt has been made to change the situation by passing the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Act 54 of 2002), which protects the interests of the banks and other financial institutions by providing ways to recover their amounts by selling the assets of the mortgagor. Now, section 69 of the Transfer of Property Act, 1882 lost its relevance in the present scenario. The Securitisation Act, has been enacted conferring powers on banks and financial institutions, if they are secured creditors, to realize the securities by sale etc., without intervention of court. The Act contains a provision overriding the provision of Section 69 of the Transfer of Property Act, 1882. Sub-section (1) of Section 13 of the said Act reads as under:

"13. (1) Notwithstanding anything contained in Section 69 or Section 69-A of the Transfer of Property Act, 1882, any security interest created in favour of any secured creditor may be enforced, without the intervention of court or tribunal, by such creditor in accordance with the provisions of this Act."

The provisions of the Act have been made applicable exclusively to banks and financial institutions as secured creditors to enforce their security interest with a view to recovering their debts. That is, if the banks and financial institutions are secured creditors having lent against securities like mortgage of immovable property, charge, hypothecation they can take over and sell such securities after giving 60 days' notice to the borrowers so as to adjust the loan, without resort to litigation in a competent court of law. The provisions of the Act cannot be considered to have been extended to the secured creditors in general. In a nutshell, the Banks and Financial Institutions in the matter of recovery of their debts ex curia can ignore the provisions of Section 69 of the Transfer of Property Act, 1882 whereas other creditors have to file a suit in a competent court for recovery of the loan. Otherwise, Section 69 of the Transfer of Property Act, 1882 still remains on the statute and is applicable to other creditors who are not Banks and Financial Institutions. Hence the suggestion for the amendment to make the law uniform to all creditors who have lent against mortgage securities.

7.8. Appeal to Appellate Tribunal:

Any person aggrieved by an order of the Debt Recovery Tribunal passed under section 17 may prefer an appeal, along with requisite fees, to the Appellate Tribunal within thirty days from the date of the receipt of the order of the Debt Recovery Tribunal. The appellant is bound to deposit fifty percent of the amount of the debt due from him, as claimed by the secured creditors or determined by the Debt Recovery Tribunal, which ever is less. However Tribunal may reduce such amount to not less than twenty five percent of the debt referred above.

In case the borrower is the resident of the State of Jammu and Kashmir, the appeal shall lie to the High Court having jurisdiction over the matter[26].

8. Important case laws under SARFAESI Act, 2002:

The Supreme Court of India and several high courts have delivered important judgments on various contentious issues, which arise under SARFAESI Act, 2002. Some of the issues and judgments are briefly discussed as under:

In Mardia Chemicals Ltd v. Union of India**[27]** laid down a strong foundation for the enforcement of SARFAESI Act, 2002. The Supreme Court upheld the validity of the Act, thereby putting an end to a large number of pending and expected litigation on the vies of the Act throughout the country. The Hon'ble Supreme Court observed that though a loan transaction may have a character of private contract, yet the question of great importance behind such transactions, as a whole having far reaching effect on the economy of the country, cannot be ignored when financing is through banks and financial institutions, utilising the money of people in general. Therefore, where public interest is involved to such a large extent, and it may become necessary to achieve an object, which serves the public purpose, individual rights may have to give way. Public interest has always been considered to be above the private interest. Even if few borrowers are affected by the enactment, it would not impinge upon validity of the Act, which otherwise serves larger interest.

In Sushil Kumar Agarwal v. Allahabad Bank[28]it has been held by the DRT that the words "without intervention of court" are more significant. If a suit had already been filed in court, there is definite intervention of court in the matter. Hence, pending its suit in the civil court, the bank cannot resort to simultaneous action under section 13(4).

InTranscore v. Union of India[29], it was held by the Supreme Court that the object of SARFAESI Act, 2002 and DRT Act, 1993 is the same, namely recovery of debts. Conceptually, there is no inherent or implied inconsistency between the remedies provided under the two Acts and they are cumulative in nature for secured creditors. Secured creditors are given the right to choose one or more of them. Though the DRT Act is a complete code in itself for recovery of debts and provides for various modes of recovery, it does not provide for expeditious enforcement of security interest of a non-adjudicatory process as has been provided for under the SARFAESI in order to prevent asset-liability mismatch in the balance sheet of the lender. It is for this reason that SARFAESI Act, 2002 is treated as an additional remedy, which is not inconsistent with the DRT Act, 1993. These two Acts together constitute one remedy and, therefore, the doctrine of election does not apply and banks and financial institutions are permitted to invoke one Act notwithstanding pendency of proceedings under the other Act. Therefore, simultaneous proceedings for the recovery of debt under the DRT Act, 1993 as well as SARFAESI Act, 2002 are permissible.

In ICICI Bank v. Shanti Devi Sharma[30], while acknowledging that banks have vast powers under the Act, the Supreme Court held that the banks also have equal responsibilities and banks and financial institutions cannot adopt unfair practices for repossession of secured assets. Unfair trade practices have no place in India, which is civilised society governed by the rule of law.

In ATV Projects India Ltd. v. State of Maharashtra**[31]** the Division Bench of Bombay High Court held that statutory and equally efficacious remedies are available to a borrower under section 17 of the SARFAESI by filing application before the DRT against the action taken by secured creditor under section 13(4) of the Act. Therefore, a borrower cannot invoke extraordinary jurisdiction of the high court under article 226 to circumvent the legal process provided under special statute.

9. Conclusion:

The enactment of SARFAESI has been a major factor in improving the health of banks and financial institution by enabling the them to reduce their NPAs to substantially lower levels. On account of availability of dual remedy, i.e., remedy under the SARFAESI and DRT Act, the banks and financial institutions have been able to substantially resolve the NPAs.the proceeding under the Securitisation and

Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 deals specifically with the secured loan i.e. asset and there are lots of complications under the Act for obtaining possession without the intervention of the court and for taking peaceful and lawful possession the Banks and Financial Institutions will constrained to file an application for support before the Chief Metropolitan Magistrate or District Magistrate, which is itself a time taking process.

Reference:

[1]Section 31 of the the SARFAESI Act, 2002.

[2]Section 2(1)(z) of the SARFAESI Act, 2002.

[3]Section 2(1)(b) of the SARFAESI Act, 2002.

[4]Section 2(1)(k) of the SARFAESI Act, 2002.

[5]2003(3) BC 626 (AII) (DB).

[6]Section 11 of the SARFAESI Act, 2002.

[7]Section 13(2) of the SARFAESI Act, 2002.

[8]Section 13(3) of the SARFAESI Act, 2002.

[9]Section 13(3A) of the SARFAESI Act, 2002.

[10]13(4)(a) of the SARFAESI Act, 2002.

[11]13(4)(b) of the SARFAESI Act, 2002.

[12]13(4)(c) of the SARFAESI Act, 2002.

[13]13(4)(d) of the SARFAESI Act, 2002.

[14]13(6) of the SARFAESI Act, 2002.

[15]Section 13(7) of the SARFAESI Act, 2002.

[16]Section 13(8) of the SARFAESI Act, 2002.

[17]Section 13(10) of the SARFAESI Act, 2002.

[18]Section 14 of the SARFAESI Act, 2002.

[19]2004 (1) Bank J 613 (Guj).

[20]Section 17 of the SARFAESI Act, 2002.

[21]Section 17(3) of the SARFAESI Act, 2002.

[22]Section 13(4) of the SARFAESI Act, 2002.

[23]Section 13(5) of the SARFAESI Act, 2002.

[24]2006(4) BC 222 (AP).

[25]2006 (133) Comp. Cas. 937 (Gau)

[26]Section 18B of the SARFAESI Act, 2002.

[27]2004 (4) SCC 311.

[28]2004 (2) BC 94 (DRT, Ranchi).

[29](2008) 1 SCC 125.

[30](2008) 7 SCC 532.

[31](2007) 6 Mah LJ 231 (Bom)