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Borrower Rights In Debt Recovery Proceedings - An Analysis.

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ABSTRACT

Debt or asset securitization is one of the latest techniques which financial markets have been witnessing. Under asset securitization, a financial institution pools and packages individual loans and receivables, creates securities against them, get them rated and sells them to investors in a market. With a view to formalize the operations of the securitization market in India and to ensure financial discipline and control in respect of the rights and obligation of the players, the legislature passed SARFAESI Act, 2002 (Securitization and Reconstruction of Financial assets and Enforcement of Security Interest Act) which overrides previous Recovery of Debts due to Banks and Financial Institution Act, 1993 , which is used as an effective tool by banks for bad loans and NPA (Non-performing assets). It is only possible when such NPAs are backed by hypothecation, mortgage or assignment. It aims to regulate securitization and reconstruction of financial assets and enforcement of security interest. It is only effective in case of secured loans where banks can enforce underlying security and the only exception is agricultural land. Another feature of this act which removes intervention of Courts in this procedure makes it speedy and swift unless the security is invalid or fraudulent.

INTRODUCTION

Process of credit cycle is a major constituent of economic growth. Non recovery of loans hurts this process, leading to Non-performing assets. Cumbersome and time-consuming legal mechanism involved in debt recovery is identified as one the factors in this regard. Hence, it was suggested that creditors, the banks and financial institutions were given power to recover dues by selling securities. In this regard, the

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Government of India appointed a committee under the chairmanship of Shri T.R And hyarujina. Based on his recommendations, the Securitization and Reconstruction of Financial Asset and Enforcement of Security Interest (SARFAESI) Act, 2002, was enacted on 17thDecember, 2002. The act provides enforcement of the security factor without recourse to civil suits. The act also allowed banks and financial institutions to utilize the services of Asset Reconstruction companies to reduce their NPAs by speedy recovery of dues from defaulters. The Act empowers the Authorized officer of the financial institution to sell the property of defaulted borrowers as under section 13 and 14 of the SARFAESI Act .

The steps taken by authorized officer is summarized as follows:

The authorized officer designated by the secured creditor issues a demand notice u/s 13(2) of the SARFAESI Act after classifying the account as NPA for repayment of the outstanding dues as laid down in the demand notice within 60 days.

The secured creditor has to consider and reply to the said objections u/s 13(3A), if the borrower may raise objections to the said notice in writing within 60 days.

The authorized officer shall thereafter be entitled to take possession of the secured assets u/s 13(4), in case of non-payment within the statutory period of 60 days. The possession may be physical or symbolic.

The authorized officer shall make a panchanama and publish the possession notice. The Chief Metropolitan Magistrate or the District Magistrate may, on an application in writing being made by the secured creditor, pass an order for taking possession through its office by taking such steps, including force as may in his opinion be necessary. However such an order is not mandatory except where an obstruction may be apprehended. He shall be required to carry out valuation of the secured asset and then proceed to sell the secured asset by public auction. However, the secured asset can also be sold by private treaty if the

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parties agree. Upon sale, the authorized officer shall issue the sale certificate.

Any person aggrieved by the action taken u/s 13(4) can file an application u/s 17 to the Debt Recovery Tribunal setting out the grounds or reasons on which the action is claimed to be wrong. The Debt Recovery Tribunal shall pass an order on the said application preferably within four months. Either party can appeal against the order of Debt Recovery Tribunal to the Debt Recovery Appellate Tribunal u/s 18 of the Act.

BORROWER'S RIGHTS:

1. **Right for objecting S.13(2) Notice**

The most Important section of Sarfaesi Act is section 13(2), which provides that if a borrower who is under a liability to a secured creditor, makes any default in repayment of secured debt and his account in respect of such debt is classified as non-performing asset, then secured creditor may require the borrower by notice in writing to discharge his liability within sixty days from the date of notice with an indication that if he fails to do so, the secured creditor shall be entitled to exercise all or any of its rights in terms of section 13(4) of the Act.

The first opportunity of being heard is provided to the borrower by section 13(3-A) which lays down that the borrower may make a representation in response to the notice issued under section 13(2) and challenge the classification of his account as an NPA as also the quantum of amount specified in the notice. The banks or other financial institutions have to communicate to the borrower the reasons for non-acceptance of their challenges within a week. Section 13(13) states that" no borrower shall after receipt of notice u/s. 13(2) transfer by way of sale, lease or otherwise any of his secured asset referred to in the notice, without prior written consent of the secured creditor". Thus, section 13(13) shows that the notice u/s. 13(2) in effect operates as an

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attachment / injunction restraining the borrower from disposing of the secure asset.

2. **Right of filing Writ petition against section 13(2) notice:**

The borrower can challenge the notice u/s. 13(2) of Act in the Civil Court as well as in the High Courts by way of writ jurisdiction to defend his case. However, that is hardly sustainable.

In the case of D. Ravichandran V/s Indian Overseas Bank[1] it was held that the notice u/s. 13(2) of Act is really a show cause notice and ordinarily this court does not interfere with show cause notice.

The notice u/s 13(2) of the Act by itself does not affect any right or liability of the borrower. Hence, challenge to the notice u/s. 13(2) of the Act is premature, since it is possible that the secured creditor may be satisfied with the reply of the borrower to the aforesaid notice and may drop proceedings.

Hence, all the wit petitions challenging the notice of u/s. 13(2) of the Act are dismissed on the ground that writ petitions are premature and the petitioners have an alternative remedy of raising all the points which they are raising in these writ petitions in their reply to notice u/s. 13(2) of the Act. It is-clear that borrower cannot approach the court or any other forum at the interlocutory stage of the proceedings that is from the issue of notice u/s. 13(2) till the final action taken u/s. 13(4) of the Act.

3. **Right of filing Appeal:**

If the borrower or any other person who had any tangible grievance against the notice issued u/s. 13(4) or action taken u/s. 14, then he/she could have availed remedy by filing an application u/s. 17(1) within 45 days from the date on which such measures were taken.

On receipt of possession notice u/s. 13(4) the borrower can prefer appeal before DRT u/s. 17, seeking stay of proceedings and to set aside the

[1] Madras High Court on 02.03.2006.

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action initiated. Does the borrower lose right to file appeal if the limitation period of 45 days from the date of the receipt of the notice u/s. 13(4) expires? No, the following cause of actions can be pleaded-

I. The borrower can question all steps initiated by the bank pursuant to section 13(4).

II. Borrower can question sale proceeding.

III. Can challenge order passed by the CMM/DM u/s. 14 of the Act.

IV. The legal preposition is well settled that court protects the rights of the borrower also.

4. **Debt Recovery Tribunal's appellate powers**:

The DRT has elaborate powers and it can even restore the possession back to the borrower, in the event it finds the actions by the bank are illegal or incorrect. The Supreme Court has clearly held in the case of Mardia Chemical Ltd.[2] that the proceeding u/s. 17 is in the nature of original proceeding and that even the amount which is claimed to be due to a bank as stated in the notice u/s. 13(2) can be challenged by the borrower. In an important decision on appellate power of DRT the High Court of Madras has held in the case of M/s Lakshmi Mills Private Ltd. v/s Indian Bank [3] as under :-

I. The right of the bank is not automatically suspended upon filing an application by the borrower u/s. 17 of the Act and secured creditor can proceed further in the matter, where no stay is granted by the Tribunal.

II. Tribunal has power to impose condition concerning deposit for grant of stay of auction

III. Tribunal has no power to pass any Interim mandatory order relating to restoration of possession before finalization of the proceeding u/s. 17 of the Act.

[2]Supreme Court on 08.4.2004.

[3]Madras High Court on 15.04.2008.

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IV. All the grounds, which rendered the action of the bank as illegal, can be raised In the proceeding u/s. 17 at the Act before the DRT.It is for the DRT to decide in each case whether the action of the bank was in accordance with the provisions of the said Act and legally sustainable.

5. **Right to approach Debt Recovery Appellate Tribunal:**

If a person is aggrieved by the order of the DRT, ha can file an appeal to the Appellate Tribunal within 30 day from the date of the receipt of DRT order. If the DRT or Appellate Tribunal holds that possession of asset by the secured creditor was wrongful and directs the secured creditors to return the assets to the borrower, the borrower shall be entitled to the compensation and costs as may be determined by the DRT or Appellate Tribunal. The Tribunal can also direct the return of the assets If the secured creditor had already sold or transferred the asset to a third party.

6**. Right of availing Interim stay order :**

The Jurisdictions of Civil Court has bean clearly barred under section 34 of the Act, stating that no Injunction shall be granted by any court or other authority In respect of any action taken or to be taken under Sarfaesi Act or the DRT Act.

The decision of the Supreme Court In the case of United Bank of India v/s Satyawati Tandon[4] is a landmark Judgment on the issue of stay orders. It was held that normally the Supreme Court does not Interfere with the discretion exercised by the High Court to pass an interim order In a pending matter but, having carefully examined the matter, an exception have been made, because the order under challenge has the effect of defeating the very object of legislation enacted by the Parliament for ensuring that there are no unwarranted impediments in the recovery of debts due to banks.

The following observations are worth noting:-

[4]Supreme Court on 26.07.2010.

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I. The High Court will ordinarily not entertain a petition under Article 226 of the Constitution, If an affective alternate remedy is available to the aggrieved person and that this rule applies with greater vigour in matters involving recovery of taxes, cess, fees, other type of public money and dues of the banks and financial institutions.

II. The High Court must insist that before availing remedy under Article 226 of the Constitution a person must exhaust the remedies available under the relevant statutes.

III. It is true that the rule of exhaustion of alternate remedy is rule of discretion and not one of compulsion, but it is difficult to fathom any reason why High Court should entertain a petition under Article 226 and pass interim order ignoring the fact that petitioner can avail effective alternative remedy by filing application, appeal, revision etc. and the particular legislations contain a detailed mechanism of redressal of his grievance.

7. **Right of filing of Writ petition under Article 226 of Constitution:**

Writ jurisdiction is an extraordinary jurisdiction of the High Court under Article 226 and 227 of the Constitution of India. There is consistency in the decisions that the High Court normally hesitates to entertain writ petition in the matter of Sarfaesi action by banks. This is in view of clear cut alternative remedy provided u/s. 17 and 18 of the Sarfaesi Act. The remedy of appeal to DRT and DRAT is available u/s. 17 and 18 of the Act, against notice for possession and enforcement of security interest.

It is settled legal preposition that a writ petition under Article 226 of the constitution is not maintainable, where there is an efficacious alternative remedy. It is generally pleaded that alternative remedy is not efficacious.

The writ petition is however preferred by the borrower for the following reasons:-

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a. Writ petition is not a costly affair, as no court fee is payable, whereas court fee has to be paid in case of appeal to DRT depending upon amount involved.

b. Writ petition once admitted takes lot of time in consideration for decision and the petitioner gets the desired breather. In comparison the matter is time bound exercise under DRT.

c. Borrowers feel that the action under the Sarfaesi Act will be automatically restrained if writ is admitted.

8. Classification of NPA can be questioned through writ

Where the Bank is not correct in classifying the account as NPA, which is preliminary to initiate proceeding under the provisions of Sarfaesi Act, the High Court does interfere with the action initiated by the bank as held in Sravan Dal Mill Pvt. Ltd. v/s Central Bank of India[5]. Further interim relief may be granted to the borrower to regularize the account by continuing making payments.

CONCLUSION :

If the intention of the Bank were to recover as much as possible from the stressed asset, it would be wise to explore OTS as first option within the RBI guidelines. It would be prudent on the part of the RBI to ensure that the OTS option is exhausted before going for securitisation and sale of the asset. The other option is to seek the Banking Ombudsman's intervention as Arbitrator to settle the distressed asset closure in cases where either the borrower or the bank has reason to believe that a mutually agreed price of the loan would be a better option than proceeding against the asset under SAFRAESI Act.

[5] Andhra Pradesh High Court on 11.09.2009