RIGHTS OF THIRD PARTY UNDER DRT and SARFAESI LAWS

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Abstract: The DRT and the securitisation laws are mostly understood and carried with the image that they are meant to protect the rights of the banking and financial institutions to recover the debt. In fact these laws have another aspect which is very sparingly touched and studied that is the rights of the 3rd party who are staying and are in possession of the property which has been mortgaged and due to the default in repayment of loan the said properties have been attached. The author in the present article have discussed and made effort to cover the rights of 3rd party under DRT and securitisation laws.

Index Terms **– Banks and Financial Institutions, DRT, SARFAESI.**

INTRODUCTION

It is truly said "*one who sleeps over his rights have no remedy in law*". Had the banking or financial institutions been sleeping till the maturity of loans passed, it would have caused a great loss to economy. The legislations have vested with the banks and financial institutions with the weapons to curb the menace of Non Performing loans. The banking institutions proved to be a stronger foundation in the nation's economy. After the Industrial Revolution, over three decades the banking system developed with leaps and bounces. There was no room for any fraudulent transactions. The lending process was moving on a good pace. The Banks could easily recover their dues on time which the machinery of circulating the money, act hurdle free. The situation aroused when the debtors started waiving off their debts by own or negligently prevented themselves to pay off debt amount. The lacunae in the law gave greater chances of escaping the loan liability. The procedure of Civil Courts in filing litigation till execution of decree was very lengthy. It took years to decide the liabilities, meanwhile the banks and other financial institutions either underwent huge losses or were closed. It was after the dawn of new legislation that provided blood and bone to the withering structure of financial economy of nation. With the intention of enabling the Banks to reduce their NPAs through faster recovery of dues, 'The Recovery of Debts Due to Banks and Financial Institutions Act, 1993' was enacted. Despite constituting 'Debt Recovery Tribunals' under the RDDBI Act, 1993 and providing special procedure to be followed before the Tribunal, Banks could not reduce their NPAs as expected and it has led the legislature to enact 'The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002'. It is all appreciable as the Banks deal with the public money and public interest is obviously involved in reducing the Banks' NPA Accounts.[1]

However, no one in this country should be denied of an effective remedy and the criticism is that the provisions of SARFAESI Act, 2002 are being misused by the Banks at times and it acted as draconian law. The issue went to Supreme Court and the constitutional validity of SARFAESI Act, 2002 was upheld, however, the judiciary was very much cautious of the interests of the borrowers and providing them an effective remedy. From then, judiciary in this country has made every effort to ensure that the object of the SARFAESI Act, 2002 is not diluted and at the same time, the interests of the borrowers are also protected. Lot of confusion was there initially as to how certain provisions of SARFAESI Act, 2002 are to be interpreted; however, many issues are settled now with judiciary taking consistent stand on many issues.[2]

We cannot simply brush aside the concerns of the borrowers and the interest of the borrowers in the property mortgaged with the Bank. Though right to property is not a fundamental right, the Supreme Court

1 Subha Rao'*Getting Relief from DTR and SARFAESI'*. retrieved from <http://drtsarfaesi.blogspot.in> visited on 20th May, 2017 at 5:00pm

2 Editorial '*Rising NPAs put Indian Banks in fix'* retrieved from <www.financialexpress.com> visited on 20th May,2017 at 5:20pm

has highlighted the significance of right to property as it is a Constitutional Right and the relevant observation of the Supreme Court in *Karnataka State Financial Corporation vs N. Narasimahaiah*[3] is as follows:-

"Right to property, although no longer a fundamental right, is still a constitutional right. It is also human right. In the absence of any provision either expressly or by necessary implication, depriving a person there from, the Court shall not construe a provision leaning in favour of such deprivation."

"In a case where a Court has to weigh between a right of recovery and protection of a right, it would also lean in favour of the person who is going to be deprived there from. It would not be the other way round."

There are many issues under the respective legislations which needs to be addressed to prevent the draconian effects on borrowers and the third parties. some of them are as follow:

a) Classification of NPA's and its settlement-

Many borrowers feel that they are being harassed by the Bank officials unreasonably and using the provisions of SARFAESI Act, 2002. They claim that they are not 'willful defaulters' and even if there is some kind of default, they are willing to correct the same and honour the commitments agreed upon. While in some cases, the Bank Officials rightly show some kind of interest in helping the borrowers within the legal frame-work, in some cases, the Bank Officials act unreasonably and invoke the provisions of SARFAESI Act, 2002 by classifying the account as 'Non-performing Asset' even if there is a possibility of regularizing the loan account.[4] Obviously, the Bank should follow the guidelines issued by the Reserve Bank of India in classifying any loan account as 'Non-performing Asset'. But, it is a question of interpretation largely and as to how the Bank Officials want to use the guidelines. Normally, the issue of classification of account as 'Non-performing Asset' is not dealt with by the Tribunal or the Courts and they tend to support the classification of any loan account as NPA if there is a default in payments as agreed.

b) Notice under section 13(2)-

The banks issues a notice to the borrower for payment of debt amount in full. The notice served includes 60 days time period to clear the liability. The time period mentioned acts prejudicial for borrower. Since it is very difficult for a genuine borrower in short period to clear the loan and that to if he is already facing uncertain loses in business or have unavoidable situations which are beyond his power. The adamant officials of bank sometimes ignore the genuine problems of borrowers and proceed accordingly which results secured asset to become a property of bank. The Hon'ble Calcutta High Court earlier in *Star Textiles and Industries Ltd vs. Union of India* [5]**,** was pleased to observe as follows:

"The legislature having conferred power on the Debts Recovery tribunal to decide as to whether measure (s) taken by the secured creditor in terms of Section 13 (4) of the Act is/are in accordance with the provisions of the Act or not, it necessarily has to decide whether pre-conditions for issuance of notice under Section 13 (2) existed or not. That would involve a determination as to whether there has been default on the part of the borrower to repay the secured debt or not and further, as to whether classification of the account as non-performing asset has been made in accordance with the directions or guidelines[6] as referred to in Section 2 (o) of the Act or not. If the Debts Recovery tribunal is satisfied that recourse has been taken to measures specified in section 13 (4) of the Act not in accordance with the provisions contained in sections 13 (2) read with 2 (o) of the Act, it has the authority to declare the action of the secured creditor as invalid. At the same time, the Debts Recovery tribunal may in a given situation find no fault and uphold the action of the secured creditor.

c) Sale of Assests-

Sale of Assets by the Bank under the provisions of SARFAESI Act, 2002 is often criticized by the borrowers. In some cases, the auction process is hurriedly completed and it would be extremely difficult for the borrowers to get the transaction set-aside though the DRT is empowered to do so under section 17. It is the responsibility of the Bank to ensure that they get the maximum possible price for the property in Public

3 2008 (5) SCC 176

4 Anup Roy & Joel Rebello. SBI to take action against defaulters, *The Economic Times* of 6th June,2011at p. 2

5 (2008 (3) WBLR 385)

6 Guidelines issued by RBI on Classification of NPAs, 2003

Auction as they are the trustees of the property and as the balance sale consideration, after adjustments, goes to the borrower.[7] There is lot of complication in this process and it is very difficult for the borrowers at times to fight with the Banks and it has something to do with the issue of lack of proper understanding of procedures and law under SARFAESI Act, 2002. Not only while auctioning the properties under SARFAESI Act, 2002, the Bank exercise enormous amount of discretion when many properties are available for auction and the disposal of a property chosen by the borrower clears the debt. Even from the point of view of the bidder or purchaser, there can be issues. There may be cases where the bidder or the purchaser paid the entire sale consideration and litigation coming to Courts leading to non-conferment of complete ownership right. If the delay between the payment of sale consideration and actual conferment of clear title is more, the bidder or purchaser is also in trouble as he will only get a minimum interest over his investment if the Sale is finally set-aside and the Bank is asked to repay the Sale Consideration to the auction-purchaser.[8]

d)Rule of Redemption-

Section 13 sub section (8) in plain language provides that no steps with regard to the transfer or sale of secured assets can take place if dues of the secured creditors together with cost charges and expenses incurred are tendered to the secured creditor at any time before the date fixed for sale/transfer.[9] Thus, a conjoint reading of the provisions of Section 13(8) on one hand and sub sections (2) to (4) of Section 17 on the other hand, bring out the position that although the right of redemption is to be ordinarily exercised before the date fixed for sale of transfer, however, even if the auction sale proceedings take place but in case the borrower succeeds in the S.A. under Section 17, the auction sale proceedings can be cancelled. There is a vital difference in this legal position and the legal position which emerges under the provisions of the CPC.[10] Whereas under relevant rules and sub rules of Order 21 of CPC, and as interpreted by the Supreme Court, even if a decree is set aside a bonafide purchaser for value at an auction sale proceedings gets a complete title in case he purchases the property without any notice of any dispute or claims with respect to the auctioned property, however under the SARFAESI Act, the DRT has complete powers under the provisions of sub sections (2) to (4) of Section 17 to set aside the auction sale and restore back the possession of the secured asset to the borrower. Clearly, therefore, the auction sale proceedings are not final under the SARFAESI Act unless the S.A.[11] of the borrower under Section 17 is decided. A purchaser at an auction sale cannot claim title merely because the auction sale proceedings for concluded in his favour and a necessary sale certificate issued as the same as per subsections (2) to (4) of Section 17 is subject to final decision on an S.A filed under Section 17.

e) One Time Settlement schemes of Banks-

It is understood that the Borrower can only question the possession notice issued by the Bank under Section 13 (4) of the Act. However, the Courts have consistently held that all measures taken by the Bank under Section 13 (4) of the Act are appealable before the Tribunal. This is very important issue and Bank is in no way gets prejudiced if the borrower is given a right to question all measures taken by the Bank. In the absence of such a provision pursuant to Court's intervention, the borrower is left with no remedy when his property worth 1 crore is sold for a meager sum of 10 lakhs by the Bank. In no stretch of imagination, it can be said that the Bank always acts fairly as it is a Public Sector Undertaking and which may not have any motives.[12]

The most important thing to be discussed is as to whether the Bank can act unfairly or illegally in the course its recovery of money. It may be true in some cases where the borrower tries to trouble the Bank in getting or recovering the outstanding due. No action of the borrower can trouble the Bank if it holds a right over 'Secured Asset' and if there is 'Secured Asset'. Banks are provided with a special legislative set-up, though

7 Section 15 of SARFAESI Act,2002
8 Section15 of Act,2002 read with Rule 8 Security Interest (Enforcement) Rules 2002
9 Para 10 of the Ram Murty Pyara Lal & Others Case, W.P. (C) Nos. 13152 of 2009
10 Order XXI of Civil Procedure Code, 1908
11 Section 2 (ZC)
12 Manager ICICI Bank Ltd. vs. Prakash Kaur 2007(2) R.C.R (Criminal) 76 Para XII

drastic, to recover its dues. Banks can not complain at the special legislation enabling it to recover its due and the borrower keep complaining at this special legislation and they keep calling it as 'draconian'.[13]

With this back-ground, the Banks are not entitled to act unfairly or illegally in the course of recovery of money. The delay tactics, at times, adopted by the borrower is no excuse for the Banks as to why it has not acted fairly as every Public Sector Bank is supposed to act fairly and strictly in accordance with law.

Here is an example as to how the Banks too can trouble the borrowers using the stringent provisions of SARFAESI Act, 2002 and it is as follows:

Facts:

A borrower avails various loan facilities including an agricultural loan from a Bank and the various loan facilities are extended to many family members. It was a 'secured loan'. The sole member/borrower who has maintained all the loan accounts from the Bank has expired and other family members are not aware of the loan facilities granted by the Bank fully. However, the family members came to know about the existence of loans with the Bank. The Bank has also sent demand notices under section 13 (2) while main borrower was alive. The Bank and Family members agreed for a 'One-Time Settlement' and receives the full amount under OTS. After the receipt of money from the borrowers, the Bank sends a communication to the borrowers saying that the 'OTS acceptance' is cancelled as the OTS was not in accordance with the regulations. After canceling the OTS, the Bank issues notices under section 13 (4) of the Act clubbing all loan facilities, however, splitting all loan facilities, into two sets. The family members of the borrowers are literally shocked. Now, the Bank proceeds under section 13 (4) without referring anything as to what has happened in-between and balance outstanding is claimed under section 13 (4).[14] Bank is supposed to take every-care while accepting the OTS and it cannot cancel the OTS after receipt of money substantial money from the borrower. It's an unfair practice unless the facts are such that the OTS cancellation is justified. Bank will be clubbing all loan facilities, but issue notices as it likes. Sometimes, there can be one notice and there can be separate notices also despite the fact that the 'Secured Asset' is one and the same. When it issues 'separate notices', the borrower will be finding it extremely difficult while approaching the Courts or the Tribunal and they may be asking the borrower to file different Appeals or Cases though the entire transaction is same in substance. The Borrower is entitled to ask for a 'Specific Performance' of OTS terms, however, it can be done in Civil Courts. DRT can say that it is not concerned with the OTS issues and even the High Court may ask the borrower to approach the Tribunal under section 17.[15]

f) Rights of Tenants-

A tenant gets vested right of tenancy or lease in the property let out. It is a transfer of leasehold interest in the immovable property and it is a substantive right. The same applies in case of statutory tenancy where tenancy rights are created by a statute. SARFAESI Act does not over ride any substantive right as stated earlier. Out of enthusiasm in equipping the Banks and Financial Institutions to recover the NPAs and to pave the way for such smooth and early recovery the judiciary has tried to overlook the substantive rights of the tenancy. Justifying such an enactment in the face of mounting dues to the Banks and in the guise of protecting public interest the Supreme Court while upholding the provisions of SARFAESI Act, has held in *Mardia Chemicals Case* [16] "it is well known that in different states Rent Control legislations were enacted providing safeguards to the sitting tenants as against the existing rights of the landlords, which before coming into force of such law were governed by contract between the private parties. Therefore, it is clear that it has always been held to be lawful, whenever it was necessary in the public interest to legislate irrespective of the fact that it may affect some individuals enjoying certain rights.

In *Hutchinsons Essar South Ltd. vs. Union Bank of India Ltd* [17] the Karnantaka High Court allowed the lessee's Writ petition challenging the action of the bank under Section 14 of SARFAESI seeking a declaration that the petitioner's leasehold rights are not regulated and covered by SARFAESI Act. The ratio decidendi in the said case was "if a bonafide third party is in occupation of the secured asset, third party lessee cannot be thrown out and the secured person can acquire on symbolic and not actual possession".

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13 Mohinder Pal Singh's Case, Para 19

14 Securitisation Act and DRT Trials- '*Problems Faced by Defendant Borrowers'* in DRT Solutions Weekly Mail- 72nd issue dated 18th September, 2009 retrieved from <http://www.drtsolutions.com> visited on 30 May, 2017 at 2:00pm

15 Ibid.

16 AIR 2004 SC 2371

17 2008(2) CLR 393

"if the purchaser of the secured asset has to take the actual possession, the same has to be in accordance with the due process of law only". "Even where the sale of assets takes place the tenant cannot be evicted without the due process of law".

g) Rights of Workmen-

Section 529A was introduced in the Companies Act, 1956 by the Companies (Amendment) Act, 1985 in order to provide a protection to the workmen and the secured lenders of the Companies. Sub Section 2 of Section 529A further provides that 'the debts payable to the workmen and secured creditors of the Company shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate the equal proportions'.

Where a claimant has proceeded with filing its claim with the Debt recovery tribunal under the provisions of Recovery of Debts Due to Banks and Financial Institutions Act, 1993 Section 19 (19) of this Act provides that where a certificate of recovery is issued against a company registered under the Companies Act, 1956, the Tribunal may order the sale proceeds of such company to be distributed among its secured creditors in accordance with the provisions of section 529A of the Companies Act, 1956 and to pay the surplus, if any, to the company.

While allowing the appeal the Hon'ble Supreme Court in *Bank of Maharashtra v Pandurang Keshav Gorwardkar & Ors* held as follows:

i. If the debtor company is not in liquidation nor any provisional liquidator has been appointed and merely winding up proceedings are pending, there is no question of distribution of sale proceeds among secured creditors in the manner prescribed in Section 19(19) of the 1993 Act.

ii. Where a company is in liquidation, a statutory charge is created in favour of workmen in respect of their dues over the security of every secured creditor and this charge is pari passu with that of the secured creditor. Such statutory charge is to the extent of workmen's portion in relation to the security held by the secured creditor of the debtor company.

iii. The above position is equally applicable where the assets of the debtor company have been sold in execution of the recovery certificate obtained by the bank or financial institution against the debtor company when it was not in liquidation but before the proceeds realized from such sale could be fully and finally disbursed, the company had gone into liquidation. In other words, pending final disbursement of the proceeds realized from the sale of security in execution of the recovery certificate issued by the debt recovery tribunal, if debtor company becomes company in winding up, Section 529A read with Section 529(1)(c) 529(3)(c) proviso come into operation and statutory charge is created in favour of workmen in respect of their dues over such proceeds.

iv. The relevant date for arriving at the ratio at which the sale proceeds are to be distributed amongst workmen and secured creditors of the debtor company is the date of the winding up order and not the date of sale.

v. The conclusions (ii) to (iv) shall be mutatis mutandis applicable where provisional liquidator has been appointed in respect of the debtor company.

vi. Where the winding up petition against the debtor company is pending but no order of winding up has been passed nor any provisional liquidator has been appointed in respect of such company at the time of order of sale by DRT and the properties of the debtor company have been sold in execution of the recovery certificate and proceeds of sale realized and full disbursement of the sale proceeds has been made to the concerned bank or financial institution, the subsequent event of the debtor company going into liquidation is no ground for reopening disbursement by the DRT.

vii. However, before full and final disbursement of sale proceeds, if the debtor company has gone into liquidation and a liquidator is appointed, disbursement of undisbursed proceeds by DRT can only be done after notice to the liquidator and after hearing him. In that situation if there is claim of workmen's dues, the DRT has two options available with it. One, the bank or financial institution which made an application before DRT for recovery of debt from the debtor company may be paid the undisbursed amount against due debt as per the recovery certificate after securing an indemnity bond of restitution of the amount to the extent of workmen's dues as may be finally determined by the liquidator of the debtor company and payable to workmen in the proportion set out in the illustration appended to Section 529(3)(c) of the Companies Act. The other, DRT may set apart tentatively portion of the undisbursed amount towards workmen's dues in the ratio as per the

illustration following Section and disburse the balance amount to the applicant bank or financial institution subject to an undertaking by such bank or financial institution to restitute the amount to the extent workmen's dues as may be finally determined by the liquidator, falls short of the amount which may be distributable to the workmen as per the above illustration. The amount so set apart may be disbursed to the liquidator towards workmen's dues on ad hoc basis subject to adjustment on final determination of the workmen's dues by the liquidator.

viii. The first option must be exercised by DRT only in a situation where no application for distribution towards workmen's dues against the debtor company has been made by the liquidator or the workmen before the DRT.

ix. Where the sale of security has been effected in execution of recovery certificate issued by the DRT under the 1993 Act, the distribution of sale proceeds has to be made by the DRT alone in accordance with Section 529A of the Companies Act and by no other forum or authority.

x. The workmen of the company in winding up acquire the standing of the secured creditors on and from the date of winding up order (or where provisional liquidator has been appointed, from the date of such appointment) and they become entitled to the distribution of sale proceeds in the ratio as explained in the illustration appended to Section 529(3)(c) of the Companies Act.

xi. Section 19(19) of the 1993 Act does not clothe DRT with jurisdiction to determine the workmen's claim against the debtor company. The adjudication of workmen's dues against the debtor company in liquidation has to be made by the liquidator. In other words, once the company is in winding up the only competent authority to determine the workmen's dues is the liquidator who obviously has to act under the supervision of the company court and by no other authority.

xii. Section 19(19) is attracted only where a debtor company is in winding up or a provisional liquidator has been appointed in respect of such company. If the debtor company is not in liquidation or if in respect of such company no order of appointment of provisional liquidator has been made and merely winding up proceedings are pending, the question of distribution of sale proceeds among secured creditors in the manner prescribed in Section 19(19) of the 1993 Act does not arise.

Conclusion-

The bank should give notice [18]of 60 days eviction to the borrower and the third parties as well, whose interests are connected with the mortgaged property, DRT/Courts should have power to adjudicate the matter separately for the interest of the third parties, if it is found that third parties has legitimate interest in the mortgaged property then, bank should not go for the auction till the final adjudication of the property. And alternative measures should be taken against the borrower.

If third party rights are created after the mortgaging the property in the bank the borrower need to inform the bank about the third party, because bank is on the same status, and if the third party rights are created then the consultation of the bank should must be taken, and bank should dictate the terms to the third parties so that the third parties may not create problems in seizing and realizing the value of properties.

[18] Section 6 read with Section 13 Of the SARFAESI Act, 2002