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Drt And Sarfaesi: Mechanisms To Prevent Menace Of Npa's

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ABSTRACT: *The Fiscal Means are one around which the world evolves. It is end in itself. The emerging barriers like fraudulent practices, money laundering, escaping debt liabilities, cheating, misappropriations etc confine its circulation to the least potential outcomes. Since changes in society always ripes into the laws in need. The legislators felt the need of the hour and to strengthen the shattering structure of banks and financial institutions, DRT and SARFAESI LAWS were encted.*
KEYWORDS: *Banks and Financial Institutions, DRT,SARFAESI.*

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I MECHANISMS UNDER DRT AND SARFAESI

Debt Recovery Laws

After independence, the Government of India decided to give impetus to the industrial development of the country. Central and State Governments encouraged banks and other financial institutions to liberalize the grant of loans and other credit facilities to the industrial entrepreneurs. With the nationalization of banks, this policy got a boost and the country witnessed rapid industrialization. The issue of repayment/recovery of loans etc. given by banks and financial institutions did not pose any serious problem in first three decades. [1]However, with the passage of time, the human greed took over the righteousness and those who were granted loans and/or other financial facilities did not bother to repay. Not only this, the efforts made by banks and financial institutions for recovery of their dues were stultified by the defaulting borrowers who indulged in unwarranted and protracted litigation in civil courts. The slow and sturdy progress of cases instituted in civil courts resulted in blocking of several thousand crores of public money, which was considered critical to the successful implementation of fiscal reform.[2] The pioneers of financial sector reforms called for early solution of this problem. Therefore, the Government of India constituted a committee under the Chairmanship of Shri T. Tiwari to examine the legal and other difficulties faced by banks and financial institutions in the recovery of their dues and suggest remedial measures. The Tiwari Committee noted that the existing procedure for recovery was very cumbersome and suggested that special tribunals be set up for recovery of the dues of banks and financial institutions by following a summary procedure.[3] The Tiwari Committee also prepared a draft of the proposed legislation which contained a provision for disposal of cases in three months and conferment of power upon the recovery officer for expeditious execution of orders made by adjudicating bodies. The issue was further examined by the Committee on the Financial System headed by Shri M. Narasimham. In its first report, Narasimham Committee also suggested setting up of special tribunals with special powers for adjudication of cases involving the dues of banks and financial institutions.[4] Even in regard to priority among creditors, Narasimham Committee made the following suggestion:

"The Adjudication Officer will have such power to distribute the sale proceeds to the banks and financial institutions being secured creditors, in accordance with inter se agreement/arrangement between them and to the other persons entitled thereto in accordance with the priorities in the law."[5]

After considering the reports of two Committees and taking cognizance of the fact that as on 30th September, 1990 more than 15 lakhs cases filed by public sector banks and 304 cases filed by financial institutions were pending in various courts for recovery of debts etc. amounting to Rs.6,000 crores, the Central Government introduced "The Recovery of Debts Due to Banks and Financial Institutions Bill, 1993" in Lok

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1 Renu sobti. *Banking and Financial Services in India- Marketing Refined*(New Delhi: New Century Publications, 2003)18
2 Ibid.
3 Rakesh Shahani. *Financial Markets in India* (New Delhi: Anamika Publishers and Distributors, 2008)478
4 Ibid.
5 Section 17A of Act, 1993

Sabha on 13.5.1993. It, however, appears that before the Bill could be passed, Lok Sabha was adjourned. Therefore, the President of India in exercise of the powers conferred by Article 123(1) of the Constitution, promulgated "The Recovery of Debts Due to Banks and Financial Institutions Ordinance, 1993", which was replaced by the RDB Act.[6] The new legislation facilitated creation of specialized forums, i.e., the Debts Recovery Tribunals and Debts Recovery Appellate Tribunals for expeditious adjudication of disputes relating to recovery of the debts due to banks and financial institutions. Simultaneously, the jurisdiction of the civil courts was barred and all pending matters were transferred to the Tribunals from the date of their establishment.[7]

The 1993 act has been introduced to provide speedy remedy for the recovery of debts, since there has been considerable difficulities experienced thereof. The legislature, therefore, in its wisdom thought it expedient to confine this remedy for the recovery of debts of more than ten lacs. For lesser amount the bank and financial institutions can avail normal remedy of civil court. The demarcation, thus, made could not be as arbitrary. Besides this, such provisions further authorize the central government to specify such amount, which shall not be less than one lac rupees. Having regard to the contingency debts less than ten lac but more than one lac can also be included within the purview of the tribunal. It was stated in *Mudit Entertainment Industries Pvt. Ltd. vs Banaras State Bank.*[8]

The word **'Debt'**[9]under the RDDBFI Act 1993 would cover any liability secured or unsecured and thus, debt Recovery Tribunal, is entitled to entertain prayer of a mortgagee for the recovery of debt as stated in *Hindustan laminators Pvt. Ltd vs Central Bank of India.*[10] Debt in simple form would compromise money owed but not necessarily restricted to money alone. Thus, in order to constitute a debt, there should be present two persons, the debtor from whom money is receivable and the creditor, to whom the money is payable. Such money payable is called "Debt". Thus the presence of a liability which is owed by debtor to the creditor is an absolute attribute of the term 'Debt'. It was stated in *G.V.Films Ltd vs Unit Trust of India*[11]. The Amendment 2000 has become necessary as judicial option was divided as to whether an amount due from any person to a bank or financial institution could be called a debt if it was legally not payable in the sense that it was a debt barred debt or, for other reasons, it was not recoverable. The supreme Court in its Judgment in *State Bank of Bikaner and Jaipur vs. Ballabh Das and Co*.[12]emphasized the definition as originally contained in S.2(g) and overruled the view that unless the amount claimed by the bank are determined for adjudicated by a competent forums, they cannot be said to be due. It was pointed out by the Supreme Court that as long as a bank has alleged in the suit that certain amount were due to bank from the respondents, that the liability of the respondent has arisen during the course of its business activity and further that the said liability is still subsisting and legally recoverable, the amount claimed would be a debt within the meaning of the definition under the Act. Any liability due from any person by a bank will constitute debt. Therefore a fraud committed by an employee of the bank cannot or should not be construed a debt. Misappropriation of the amount of the bank by its employees and recovery thereof by way of suit can never be construed as a debt, as stated in *Bank of India vs. Vijay Ramnikal Kapadia*[13] It is immaterial that the embezzled or misappropriated amount is allowable as business expenditure. The same would not alter the character or nature of the liability to one arising during the course of the business undertaken by bank. It was held in *Oriental Bank of Commerce vs Mohan Gupta*.[14]

The Debts Recovery Tribunal have been constituted under of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.[15] The original aim of the Debts Recovery Tribunal was to receive claim applications from Banks and Financial Institutions against their defaulting borrowers. For this the Debts Recovery Tribunal (Procedure) Rules 1993 were also drafted. While initially the Debts Recovery Tribunals did perform well and helped the Banks and Financial Institutions recover substantially large parts of their non performing assets, or their bad debts as they are commonly known, but their progress was stunted when it came to large and powerful borrowers. These borrowers were able to stall the progress in the Debts Recovery Tribunals on various grounds, primarily on the ground that their claims against the lenders were pending in the civil courts, and if the Debts Recovery Tribunal were adjudicate the matter and auction off their properties irreparable damage would occur to them.

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[6] Legislative History of the Act,1993
[7] Section 17 and 18 of the Act,1993
[8] A.I.R 2000 All 181: 2000A.I.H.C 3496 (D.B)
[9] Section 2(g) of the RDB Act defines 'Debt'
[10] A.I.R 1998 Cal.300
[11] (2000) 100 Comp. Cas. 257 (Mad.) (D.B)
[12] A.I.R 1999 S.C. 3408
[13] A.I.R. 1997 Guj.75
[14] (1996) 62 Del.L.T.239
[15] Section3 of the Act,1993

Apart from the above big lacunae, there were a number of short comings too. The dues of work men against a company, the State dues, and the dues of other non secured creditors all got enmeshed before the Debt Recovery Tribunals. As if these were not sufficient, there was clash of jurisdiction between the Official Liquidators appointed by the High Courts and the Recovery Officers of the Debts Recovery Tribunals. The Official Liquidator, an appointee of a superior authority, took into his possession all the properties, which actually belonged to secured creditors who claims before the Debts Recovery Tribunal. The High Courts also took umbrage on the activities of the Recovery Officers who away the entire amounts and paid off to the banks leaving nothing for the other claimants, including the work men. All these and other issues lead to drastic amendments to the Recovery of Debts Due to Banks and Financial Institutions Act by means of an amending notification in the year 2000.[16]

Legal Mechanism under the Act

RDB Act contains procedure required to be followed by the Tribunal [17]for deciding an application made for recovery of debt. It envisages making of application by a bank or a financial institution for recovery of any debt from any person, issue of summons to the defendant to show cause as to why relief prayed for may not be granted to the applicant and also provides for passing of appropriate orders. After giving reasonable opportunity to both the parties the tribunal passes the final order. It is sole discretion of bank or financial institution to stay with the tribunals order thereby taking possession of the secured assets and affect its sale to realize the blocked money. The other measure is to move under SARFAESI Act,2002.

Over the years the Debts Recovery Tribunals have evolved into fine bodies with lot of expertise. There is a plethora of judgments from the Supreme Court as well as the various High Courts which have paved the way of the Debts Recovery Tribunals to chart their courses. The Debts Recovery Tribunal of India have become model institutions for many countries to follow. The Central Government shall by notification establish one or more Appellate tribunals known as Debt Recovery Appellate Tribunal to hear the appeals from the DRTs.

Securitisation of Financial Assets and Enforcement of Security Interest Act, 2002

Discouraged by the dismal performance of DRT's in recovering the dues of banks and financial institutions, the legislature to effectively recover the money of banks and financial institutions, enacted the securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest act 2002 (Securitization Act 2002). Narasimham Committee I and II and Andhyarujina Committee constituted by the government for the purpose of examining banking sectors reforms have considered the need for changes in the banking system in respect of these areas. These Committees, inter-alia, have suggested enactment of a new legislation for securitisation and empowering banks and financial institutions to take possession of the securities and to sell them without intervention of the Court. Acting on these suggestions, the Securitisation and Reconstruction of Financial Institutions and Enforcement of Security Interest Act was passed in 2002 to deal with Securitisation and matters of Non-Performing Assets connected therewith or incidental thereof.

This Act bypassed the process of adjudication of disputes either by the civil courts or the DRT's. It attempted to reach the stage of execution forthwith and curtail the time spent on adjudication of disputes. This is a revolutionary piece of legislation; it transports the laws of recovery from a bullock-cart age to rocket age. The legal system and the society perhaps was not ready for such a change, therefore, the new law met with roadblocks throughout its way.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 like the Code of Civil Procedure, 1908 is a procedural law. The only difference is that in the latter procedures are provided through the Court while in the former procedures can be directly effected by the secured creditors for realization of enforcement of security interest in the secured assets and the action or measures taken by the secured creditors are made subject to the right of the aggrieved party to prefer appeal before the Debt Recovery Tribunal and the second appeal before the Appellate Tribunal.[18]

Securitization act provides for one of the remedial measures to a particular class of secured creditors i.e. banks and financial institutions may enforce any security interest created in their favour with the intervention of the court or tribunal. The scope of the remedy is limited only to the secured assets and security interest created in the property. While the remedy under the normal law is wide and can even extend to the personal assets of the debtor.[19]

The Act provides that no Asset Reconstruction Company shall commence or carry on the business of securitization or assets reconstruction without obtaining of registration under the proposed legislation and

[16] P.S.Narayan. *Recovery of Debt Due to Banks and Financial Institutions Act,1993*. 42

[17] Section 19 of the Debt Recovery Tribunals,1993

[18] Apex Electricals Ltd., vs ICICI Bank Ltd. (2003) 117 Comp Cas 412 (Guj)

[19] Apex Electricals Ltd vs ICICI Bank Ltd. (2003) 117 Comp Cas 412 (Guj)

having the owned fund of less than two crores or such other amount not exceeding fifteen percent of total financial assets to be acquired by the securitization company or reconstruction company, as Reserve Bank may, by notification, specify.[20] The Act empowers Reserve Bank of India to cancel the Certificate of company which ceases to carry the business of assets reconstruction and ceases to hold any investment from a qualified buyer.[21]

In order to avail the powers enshrined in the Securitization Act 2002, the following conditions must be fulfilled:

(i) existence of security interest;
(ii) in favour of secured creditor;
(iii) borrower must be under a liability to the secured creditor;
(iv) default in repayment of security debt or installment thereof;
(v) debt must be classified as a non-performing asset;
(vi) Issuance of notice by the secured creditor to the borrowers.

Exception to Securitization Act 2002

The securities as mentioned herein above admit certain exceptions, which shall not attract the mischief of the Securitization Act 2002. the exceptions are provided in the Securitization Act 2002,[22] and include the following:

(a) a lien on any goods, money or security given by or under the Indian Contract Act 1872 or Sale of Goods Act 1930 or any other law for the time being in force;
(b) a pledge of movables within the meaning of section 172 of the Indian Contract Act 1872
(c) creation of any security in any aircraft as defined in cl (1) of section 2 of the Aircraft Act 1934;
(d) creation of security interest in any vessel as defined in clause (55) of section 3 of the merchant shipping Act 1958;
(e) any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;
(f) any rights of unpaid seller under section 47 if the sale of Goods Act 1930;
(g) any properties not liable to attachment or sale under the first proviso to sub-section (1) of section 60 of the CPC;
(h) any security interest for securing repayment of any financial asset not exceeding one lakh rupees;
(i) any security interest created in agricultural land;
(j) Any case in which the amount due is less than 20 percent of the principal amount and interest thereon.

Thus, it means that banks and financial institutions cannot exercise the powers conferred upon them under section 13(4) of the Securitization Act 2002, in respect of any assets, which are either owned by the borrower or are in the custody and possession of the borrower, where there is a prior interest of an independent party by way of a lien, pledge, conditional sale, hire-purchase, lease or as unpaid seller.

Further, where the security interest is in an aircraft or shipping vessel, agricultural land or property exempted from attachment under CPC[23], the Act shall not have any force. Besides, the securitization Act 2002 shall not have any application where the value of security interest is less than Rs one lakh or where 80 percent of consolidated amount of principal and interest has been paid.

Securitisation of financial assets is a financial tool for the lenders to securitise their future cash flows from the secured assets and thus to release their funds blocked in them. The secured assets become a market commodity having financial returns on their realisation. This aspect brings in the much-needed expertise in adept handling in realisation of the secured assets. The Act has made an attempt to streamline the legal impediments of normal civil law procedures to foreclose the mortgaged assets by empowering the enforcement of the secured assets by flexible mechanism provided in the Act.

Securitization can be explained as a process of accumulating the assets having a fixed income stream into one product and converting them into marketable securities for a subsequent sale to investors. These marketable securities are secured by the assets themselves. Hence, the main aim of a firm/ concern in this exercise of securitization is to obtain access to low cost capital that is otherwise unavailable through conventional means.

The process involved in securitization transaction includes several steps. The originator pools the similar set of assets that generate a predictable stream of payment and sells/ assigns them to special purpose vehicle (SPV). Any asset having a cash flow profile over a period of time can be securitized. Some of the assets

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[20] Section 3
[21] Section 4 of Amendment act, 2016
[22] Section 31, Securitization Act 2002

[23] section 60 of CPC, 1908

which have the potential to be securitized are housing loans, car loans, term loans, export credits, and future receivables like credit card payments, ticket sales, album sales, car rentals, electricity and telephone bills receivables etc. These assets are known as 'financial assets'.[24]

Legal mechanism under the Act

A debt which has been defaulted in payment, must be classified as NPA. And account becomes NPA if it does not earn interest for a period of six months.

This Act defines the expression 'non performing assets'[25]of the Act. In order to classify a debt as NPA, it must be classified by the banks and financial institutions as sub-standard, doubtful or loss in accordance with the guidelines laid down by the Reserve Bank of India.

Lastly, before initiating any action under the securitization Act 2002, it is necessary that a mandatory notice be sent to the defaulter.

The Act contemplates a notice before resorting to the remedies provide under section 13 of the Act. It is required that the notice should be issued by the secured creditor in writing, wherein the secured creditor may require the borrower to discharge in full his liability to the secured creditor under section 13(4) with 60 days from the date of notice. If the borrower fails to pay up within the stipulated time, the secured creditor shall be fee to proceed against the borrower under the provisions contemplated under section 13(4) of the Securitization Act 2002.

The notice of demand should state the amount payable by the borrower to the secured creditor and the details of the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debt. It is incumbent upon the borrowers not to transfer by way of sale, lease or otherwise any of the secured assets after the receipt of notice. The transfer may take place with prior written consent of the secured creditor.[26]

The Supreme Court in *Mardia Chemicals* [27] has held that the borrower shall have a right to reply to the notice and the banks and financial institutions shall consider the reply of the borrower before taking an action under section 13(4) of the Act. The borrower should be informed about the decision of the banks and financial institutions. This judgment has given a breather to the borrowers against an action under section 13(4) of the Act.

As stated above, banks and financial institutions have been given wide powers to collect their dues. The powers are so exhaustive that initially this Act was addressed by some segments of society and industry as a draconian law. It needs to be seen how successful the banks and financial institutions are in taking the benefits of this Act.

The powers of the secured creditor under this Act have been stated in the Act. The powers, inter alia, include the following:

(a) take possession of the secured asset of the borrower;
(b) take over the management of the secured asset;
(c) transfer the secured asset by way of lease, assignment or sale;
(d) appoint any person to manage the secured asset; and
(e) require the payment of their debt from the persons who acquire the same from the borrower.

Section 17 of the securitisation act 2002[28] provides an appeal against the action of the secured creditor under section 13(4) of the act. The appeal has to be made to the DRT within 45 days from the date on which such measures had been taken. Earlier, there was a provision which provided that an appeal the measure of section 13(4) of the act shall be entertained only on the deposit of 75 per cent of amount claimed in the notice. The Supreme Court in *Mardia Chemicals* has declared this provision ultra vires of the Constitution, and hence, an appeal could be field without deposit of 75 per cent of amount claimed. The Act provides for the provision relating to the appeal to appellate Tribunal[29]. Sub-clause (1) States that any person aggrieved by an order made by the Debt recovery tribunal under clause 17 may prefer an appeal to the Appellate tribunal within thirty days from the date of receipt of the order of DRT.

If the Debt recovery Tribunal or the Court of District Judge, on an application under Section 17 or section 17-A or the Appellate Tribunal or the High Court on an appeal preferred under Section 18 or Section 18-A, holds that the possession of secured assets by the Secured creditor is not in accordance with the provisions of

[24] Shantimal Jain.*Securitization law: scritinised* (Lucknow:eastern book company,2004)78
[25] Section 2(o), Securitsation Act 2002
[26] Section 6
[27] Mardia Chemicals Ltd vs Union of India, (2004) 110 DLT 665
[28] Section 17, Securitisation act 2002
[29] Section 18

the Act and rules made there under and directs the Secured Creditors to return such secured assets to the concerned borrowers, such borrowers shall be entitled to the payment of such compensation and costs as may be determined by such Tribunal or Court referred to in section 18-B.[30]

The Doctrine of Election

Where two different remedies are available to a creditor, what remedy can he opt for. Can he select any one of the two or both the remedies can be taken up simultaneously. Under the securitization act the remedy is available to a class of secured creditors viz. banks and financial institutions only against the secured assets while at the same time remedy is also available under the recovery of debts due to banks and financial institutions act, to the banks and financial institutions and the remedy is not limited to the secured assets only, it can even be extended to the personal assets of the debtor. In the case of *Apex Electricals Ltd. vs ICICI Bank Ltd.* [31]some of the petitioners had raised the plea that the doctrine of election would be applicable. The court while discussing in detail the doctrine of election held:

"In the case of *Nagubai Ammal vs B. Sharma Rao* [32] while considering the contention for doctrine of election, the apex court observed at para 23 portion is as "It is clear from the above observations that the maxim that a person cannot approbate and reprobate is only one of the application of the doctrine of election, and that its operation must be confined to relieves claimed in respect of the same transaction and to the persons who are parties thereto.

The apex court abstracted from *Halsbury`s Laws of England,*[33] as under:

"On the principle that a person may not approbate and reprobate, a species of estoppel has arisen which seems to be intermediate between estoppel by record and estoppel in pais, and may conveniently be referred to here. Thus a party cannot, after taking advantage under an order (e.g., payment of costs), be heard to say that it is invalid and ask to set it aside, or to set up to the prejudice of persons who have relied upon it a case inconsistent with that upon which it was founded; nor will he be allowed to go behind an order made in ignorance of the true facts to the prejudice of third parties who have acted on it."

II CONCLUSION

The intent of the legislature is crystal clear in providing two beneficial statutes to the society. The progress and means of any society is based on its economic structure and factors which hamper the circulation of the economy should be done away with. Banks and Financial Institutions are responsible for the growth of economy. The stringent Provisions ensure that nobody will be given to take benefit of wrongs by avoiding the loans or escaping from liability arising under the Act. DRT are playing a Significant role in preventing the increasing ratio of NPAs.

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[30] Section 19
[31] (2003) 117 Comp Cas 412 (Guj) followed in Vandanaben Rasik Dagli vs Royal Coop Bank Ltd (2006)
65 SCL 11 (Guj)
[32] AIR 1956 SC 593
[33] volume 13, page 454, para 512