



# LAW OF FINANCIAL MARKETS & TRANSACTIONS IN INDIA

## Session 2 : Lending & Security Laws

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***LAWS ON CREATION,  
PROTECTION &  
REGISTRATION OF  
SECURITY INTERESTS***

# Security Interest

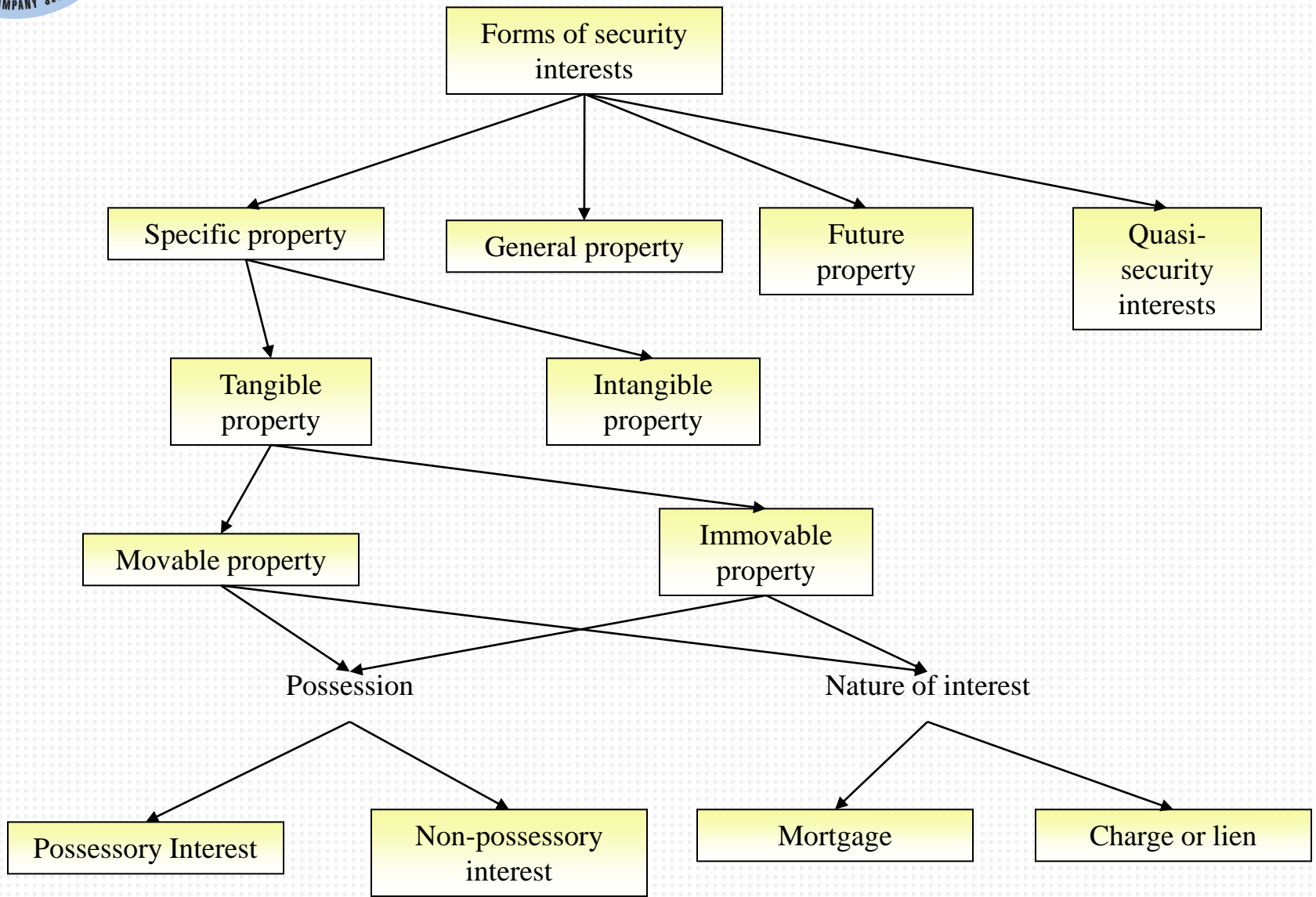
## Definition:-

*Section 2(zf) of the SARFAESI Act, 2002 defines “Security Interest” as “right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31”.*

## Deriving from the definition- Forms of Security Interests:-

- Mortgage
- Charge
- Hypothecation
- Assignment

# Broad forms of Security Interests



# Indian Security Interest Enforcement Law

- ❑ Law distinguishes between security interests based on the nature of the collateral:
  - *security interests on immovable properties*
    - *Chapter IV of Transfer of Property Act*
    - *Registration provisions of the Registration Act*
    - *Attachment provisions of the Civil Procedure Code; order XXXIV*
  - *security interests on movable properties*
    - *by corporate bodies:*
      - *receivership in case of debentures*
    - *by non-corporate bodies*
      - *security interests being pledge*
      - *security interests other than pledge*
  - *interests in actionable claims*
  
- ❑ Based on the security interest holder
  - *Security interests held by banks and financial institutions*
  - *security interests held by State Finance Corporations*

# Creation of Mortgages

## Forms of mortgage:

- *Legal mortgage*
- *Usufructuary mortgage*
- *Simple mortgage*
- *Mortgage by deposit of title deeds or equitable mortgage*
- *Mortgage by conditional sale*
- *Anomalous mortgage*

The most common form is mortgage by deposit of title deeds

- *Usual course is to have a memo of deposit of title deeds recorded*

## Immovable Properties - Mortgages

- Mortgage is the transfer of interest in specific immovable property as security
- Mortgage and charge - distinction - mortgage is a transfer of interest in property; charge is merely a security interest
- Types of mortgages:
  - *(a) simple mortgage: personal undertaking to pay coupled with right of mortgagee to sell the property*
  - *(b) mortgage by conditional sale*
  - *(c) usufructuary mortgage - transfer of possession, rent and profits*
  - *(d) English mortgage - transfer of property*
  - *(e) Equitable mortgage*
  - *(f) Anomalous mortgage*
- Most bankers' mortgages fall under (a) or (e). Some mortgages fall under (f)



# Mortgages of Movable Property

Mortgages of movable property can be created by conditional sale

- Borrower sells property to lender
- With an agreement on the part of the lender to either revoke the sale or retransfer property
- This creates a mortgage
- Being a transfer of title, mortgages are stronger than hypothecations

# Redemption and Foreclosure

- ❑ Redemption - redemption of mortgage on satisfaction of debt - sec. 60
  - *after principal money has become due*
  - *redemption is a statutory right; anything to the contrary will be a clog on equity of redemption*
  - *as redemption is a statutory and permanent right, a foreclosure of such right is permitted only by decree*
  
- ❑ Sec. 67 - a decree denying mortgagor of right of redemption or granting mortgagee right to sell:
  - *foreclosure - closure of the right of redemption and making the conditional transfer of property absolute*
  - *sale - permitting the mortgagee to sell*
  - *foreclosure and sale are distinct, and u/s 67 (a) mutually exclusive. Rule 2/3 of CPC deal with foreclosure; rule 4/5 deal with sale.*



# Redemption and Foreclosure (continued)

- ❑ Sec 69 - mortgage shall have power to sell without intervention of Court only in cases specifically covered by the section.
  - *3 months' notice in writing -sec 69 (2)*
  - *power of the purchase not impeachable on ground of irregular sale*
  
- ❑ In cases covered by sec 69, the mortgagee can appoint a receiver - sec. 69A

# Right of Foreclosure/Sale

- Foreclosure- applicable to conditional sales only. Sale - not applicable to conditional sale and usufructuary mortgage - sec. 67 (a)
- Simple mortgages do not carry a right to foreclose or right to get possession
  - *a mortgage transferring the right to sell may be regarded as anomalous mortgage*
- Equitable mortgages at par with simple mortgages - sec 96
- Only after the mortgage money has become due
- Non-payment of interest does not accelerate the right to foreclose, unless specifically agreed - Yeo Htean Sew v Abdul Zaffar. Interest is accessory to principal and not separately recoverable
- Partial redemption/foreclosure - unless severed with consent of parties
- sec. 67A - multiple mortgages - mortgage should consolidate the mortgages

# Claim for Mortgage Money

- Sec. 68 deals with claim for mortgage money, that is, personal claim.
- Only where the mortgagor has bound himself to pay
- In a mortgage, the personal liability of the mortgagor is secondary-primarily, creditor should exhaust remedies against the property - sec. 68 (2)
- However, in case of equitable mortgages, there is an implied personal liability



# Charges

Sec 100 of TP Act defines a charge - any security interest other than a transfer of an interest

Unregistered mortgage is not a charge

Provisions of simple mortgage applicable to charges also

Hence distinction not important from viewpoint of recovery rights - similar substantive and adjective law in Order XXXIV, rule 15 of CPC applies to charges

# Fixed Vs. Floating Charges

- ❑ Essential distinction - whether the borrower has the right to deal with the property subject to charge or not. Where right to deal exists, charge is a floating charge. - Macnaughten's famous comment in *Houldsworth vs Yorkshire Woolcombers*
  
- ❑ Floating charge does not crystallise until the end of the company's right to deal with the charged assets - *Imperial Bank of India*
  - *appointment of a receiver and company ceases to be going concern: sec. 123 of the Companies Act*
  - *company going into winding up*
  - *event specified in the charge document*
  
- ❑ Fixed charges created prior to crystallisation take priority - *Narendra Kumar Maheshwari SC 1989*

## Fixed Vs. Floating Charges (continued)

- in New Bulla Trading Ltd (1994), Court approved a clause under which lender had fixed charge on receivables not collected, and floating charge on those collected. New Bullas reversed by House of Lords in Brumark.
- In Brumark's case [Agnew vs. Inland Revenue Commissioners 2001 2 AC 710] House of Lords set important distinguishing criteria for fixed vs. floating charges on receivables
- Unless the collection of receivables is actually controlled by the chargee, the charge must be a floating charge
- In the ruling in Cosslett this decision was extended to movable properties as well.





# Recent Rulings on Fixed and Floating Charges

*Brumark and Cosslett's* case were followed by National Bank of Westminster:

- Essential distinction between fixed and floating charges re-established.
- Where seller cannot be deemed to have a control over the asset, the charge deemed to be floating
- Floating charges subordinated to fixed charges

# Pledges of Movable Property

- ❑ Sec. 172 of Contracts Act covers bailment of pledges -that is, transfer of possession for security.
- ❑ Pledge means transfer of possession without property; the reverse case is a case of hypothecation.
  - *Pledge and hypothecation depends on who has effective control on possession - Gopal Singh Hira Singh v Punjab National Bank SC*
- ❑ Actual or constructive delivery essential for a pledge; a mere license to take delivery is not a pledge
- ❑ in case of documents requiring endorsement, a mere delivery is not a pledge
- ❑ Rights of the pawnee:
  - *right to retain the pledged goods - sec. 173*
  - *right to claim expenses - sec. 175*
  - *right to sue for payment - sec 176*
  - *right to sell the pledged goods - sec 176*

# Hypothecation of Movable

- ❑ Simple mortgage of movables, not being a pledge, has been regarded as hypothecation - *Cooperative H Bank v. Surrendra* ILR 59 Cal 667
- ❑ No specific provision in Contracts law
- ❑ Hypothecatee is supposed to be in legal possession of the goods though the debtor has physical possession. Right of repossession specifically conferred can be exercised without intervention of Court (however, more case law in recent times):
  - *AP High Court in State Bank of India v Shah Ali*
  - *MP High Court in Chirangi Lal v. Central Bank of India*
- ❑ Floating charges in case of non-corporate borrowers - applicability questioned in England on the doctrine of reputed ownership

# Hypothecation over Fixed Assets

- ❑ Globally known as a lien, hypothecation is a non-possessory security interest where the debtor agrees to make an asset available to discharge claims of the creditor
  
- ❑ There is no specific law relating to hypothecation:
  - *It is essentially contractual law*

# Security Interests over Receivables

- ❑ Security interest over receivables can be created by assignment
- ❑ Assignment u/s 130 of TP Act can be for 2 purposes:
  - *Absolute assignment, that is, for sale*
  - *Assignment by way of security*
- ❑ Requisites:
  - *Written agreement (stamping implications)*
  - *Notice to debtor*
- ❑ General consensus is that absence of notice to debtor does not vitiate the assignment : remains valid as equitable assignment

# Is Debt Assignable?

- ❑ Assignment of a contract vs assignment of benefits under a contract
  - *Benefit under a contract is a property, assignable at the free discretion of the assignor*
    - *SC ruling in Indu Kakkar*
  - *A contract contains mutual obligations: hence, contracts can be novated, not assigned*
  - *If a right is subject to mutual obligations, such that the same are unseverable, the rights are not assignable without consent of the counterparty*

# Various Forms of Assignment

- ❑ From viewpoint of intent
  - *Assignment for the sale*
  - *Assignment for security interest*
  
- ❑ From viewpoint of completion
  - *Legal assignment*
    - *Complete as against the debtor*
  - *Equitable assignment*
    - *Incomplete as against the debtor; obligor notice not given*
    - *SC ruling in Bharat Nidhi Ltd recognises equitable assignments, based on certain procedure*



# Various Forms of Assignment (continued)

- ❑ From viewpoint of applicable law
  - *Assignment of actionable claims*
    - *Procedure of sec 130 of TP Act applicable*
  - *Assignment of receivables other than actionable claims*
    - *Essential procedure of law is still to be complied with to perfect the transfer*
  - *Assignment under SARFAESI Act*
    - *Very limited applicability, only to a securitisation company*



# Implications of Assignment

- Written instrument for transfer is treated as conveyance, would need stamping
- Relaxation of stamp duty in several states
  - *Limited reduction of duty in several states*
- Practices in other countries to avoid stamp duty
  - *Declaration of trust*
  - *Oral transfers*
  - *Incomplete transfers*
  - *Transfers in other jurisdictions*

# Whether Assignment Legal?

- ❑ Kotak Mahindra Bank vs IDBI III (2007) BC 302 (Del) (DB): assignment legal
- ❑ Division Bench of Gujarat High court in Kotak Mahindra Bank vs APS Star Industries, ruling dated 12 Jan 2009, took a different view
  - *The ruling of SC in APS Star Industries [2010 10 SCC 1] has reversed the above finding*



***SARFAESI ACT, 2002  
& PROCEEDINGS UNDER  
SARFAESI ACT***

# SARFAESI Act, 2002 : Overview

- ❑ The act was introduced to manage the large increase in the number of NPA stocks with the banks through a process called Securitisation.
- ❑ It enables the Banks and Financial Institutions to :
  - *Realise the Long term assets.*
  - *Manage problems of liquidity & asset-liability mismatch.*
  - *Improved recovery by taking of possessions.*
  - *Reduce NPAs by adopting measures for recovery or reconstruction.*

# Meaning of Security Interests

- ❑ Security interest under the law has 4 elements:
  - *secured debt/ financial assistance*
  - *security interest*
  - *secured creditor*
  - *Borrower*
  
- ❑ Sec 2 (1) (zf) - right title and interest of any kind whatsoever, including mortgage, charge, hypothecation, assignment
  
- ❑ right title or interest - obviously meaning those created for security
  
- ❑ Mortgage - sec 58 of TP Act is limited to immovable property. Generally, conferring any right to a lender to sell property on default



# Meaning of Security Interests (continued)

- Hypothecation - sec. 2 (1) (n) - all charges except a pledge
- Charge - by itself, does not mean anything but security interest. Sec 100 of TP Act - a security interest not being a mortgage. Any interest in property defeasible or destructible on repayment of a debt - Bond Worth Limited (1980) Ch
- Assignment - assignment by way of security, and not assignment by way of transfer

# Secured Creditor - sec 2 (1) (zd)

- Bank*
- financial institution:*
  - *Includes power to notify financial companies*
- In case of debentures:*
  - *unsecured debentures do not seem to be covered (last line of definition)*
  - *secured debentures - rights exercisable by trustees*
- debenture trustee appointed by any bank or financial institution:*
  - *misnotion- debenture trustees are appointed by the charge-creator and assented to by the beneficiary*
  - *could create confusion where debentures are held by non-banks as well*
- securitisation company and reconstruction company*
- any other trustee holding securities on behalf of a bank*

**"secured creditor" means any bank or financial institution or any consortium or group of banks or financial institutions and includes-**

- debenture trustee appointed by any bank or financial institution; or**
- securitization company or reconstruction company; or**
- any other trustee holding securities on behalf on a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance;**

# Borrower

- Key word is “financial assistance”
- Any person who has availed of financial assistance
- guarantor:
  - guarantee as defined in sec.126 of Contracts Act*
  - does not include contracts of indemnity*
  - consent of the principal debtor important*
  - issue: can rights under the law be enforced against the guarantor as principal obligor- apparently yes*
- Liability of the guarantor – SC ruling in ICICI v. Biswanath Jhunjhunwala, ruling dated 18<sup>th</sup> Aug 2009- liability of the guarantor is co-extensive, not alternative



## Borrower (continued)

- provider of security
  - only mortgage and pledge included here*
  - usually security provider will also be a guarantor*
  
- borrower of securitisation company
  
- makes no distinction between corporate and non-corporate borrower
  
- Continued relation between lender and borrower important - after assignment, lender cannot operate against the borrower

# Secured Asset

- Meaning is important, as the rights under the law exercisable against secured assets
- Sec 2 (1)(zc) - assets over which security interest created
- Requisites:
  - *the security interest must be specific to the asset*
  - *the interest must be in the nature of security interest*
- Floating charges: interest does not become specific until receivership/ winding up action
- Can the process of this law be taken as receivership?
  - *The rights to take possession of the assets under this law are akin to rights of a debenture holder to appoint receivers u/s 123*
  - *The process under this law should amount to crystallization of the charge*
  - *however sec 13 (13) may create difficulties*

# Exceptions under sec. 31

- Lien on goods, money or security under Contracts law or Sale of Goods Act:
  - a very confusion clause, as essentially, all security interests are liens and all such liens by contract of parties are given under Contracts law*
  - intent to exclude bailee lien u/s 170, banker's lien u/s 171*
  - unpaid seller's lien u/s 47 of Sale of Goods Act*
  
- pledge
  - generic rights under Contracts law applicable*
  
- creation of security in any aircraft
  
- creation of security in vessels

## Exceptions under sec. 31 (continued)

- conditional sale, hire purchase or lease or any other contract in which no security interest has been created
  - exclusion of conditional sale unreasonable; conditional sales regarded as lending transactions - Sundaram Finance v State of Kerala*
- rights of unpaid seller
- properties not liable for attachment under CPC:
  - exclusions under sec. 60 of CPC; most include personal effects, LIP, public provident fund*
- where financial assistance not exceeding Rs 1 lac

## Exceptions under sec. 31 (continued)

- where dues are less than 20% of principal and interest
- agricultural land
- The provisions of Section 31(e) are not attracted in the event any security interest is created in contracts like contract of sale or hire purchase or lease, unless such transactions result in creation of security interest which is similar to a loan.
  - *Indian Bank vs M/S Nippon Enterprises South, ([http://www.indiankanoon.org/doc/645192/.](http://www.indiankanoon.org/doc/645192/)), 2011, Madras High Court.*
  - *Manokamna Steel Pvt. Ltd. v. Punjab National Bank [(2012) II BC 206 Uttarakhand]*
    - *Security interest created on lease by deposit of title deeds. Act applicable*

# Agricultural Land

- ❑ Meaning of agricultural land:
  - *Actual usage as such important, merely that the land may be used for agricultural purposes is not sufficient*
  - *Sense of the word – tilling or ploughing of the land important: Benoy Kumar Saharoy AIR 1957 SC 768s*
  
- ❑ In Gajula Exim P Ltd v. Authorised officer, Andhra Bank, IV (2008) BC 274, High court held merely payment of land revenue is not sufficient to establish agricultural land
  - *Business of seafood is not agriculture*
  
- ❑ Cultivation of cardamom comes within the term agriculture and SARFAESI Proceedings cannot be initiated against the cardamom estate -- J. Malliga & Others A.O. Union Bank Of India 2010(2) DRTC 143(Madras)
  
- ❑ Land planted with rubber be treated as an agriculture and SARFAESI Act cannot be invoked -- Mohd. Basheer Vs Kannur District Cooperative Bank Ltd 2010(2) DRTC 123 (Kerala) DB

# Enforcement of Security u/s 13

- ❑ Sec. 13 overrides sec. 69/ 69A of TP Act, not however, sec. 67
  - *The specific mention of Sections 69 and 69A of the TP Act in the non obstante clause indicate the exclusion of the other provisions in the TP Act from the purview of the non obstante clause.*
  - *However, by sec 35, the SARFAESI Act overrides all inconsistencies of all other laws.*
    - *Pushpangadan v. Federal Bank Ltd. [(2012) II BC 115 Ker. (FB)]*
  - *Sec. 67 (a) puts an important distinction between right of foreclosure and right of sale. A normal charge holder has a right of sale, not right of possession*
  - *Remedies under this law are not to the exclusion of other rights - e.g., DRT proceedings, decree of Civil Courts*



# Enforcement of security u/s 13 (continued)

## ❑ Requisites for action u/s 13:

- *borrower, under liability to secured lender*
- *makes default in repayment of a secured debt or installment: any default of agreement cannot trigger the power*
- *account classified as NPA under RBI norms: banker's books to be evidence*
- *creditor requires borrower in writing to discharge "all his liability" within 60 days of notice*
- *notice to specify amounts due and the details of secured assets*
- *effect of notice: freeze on sale lease or transfer u/s 13 (13)*
- *freeze in case of floating charges? Details of secured assets?*
  - *Notice only demands payments. Does not amount to receivership.*

## ❑ Rights under sec 13 (1):

- *are rights to enforce security interest; do not confer any new rights not implied by the agreement between parties. It is only the interest created which can be enforced.*
- *principles of natural justice applicable*



## Notice under sec. 13 (2)

- Minimum contents of the notice
  - *Transparency is quite important*
  
- In case after the notice, there have been discussions of settlement or MoU etc., it is advisable to serve a fresh notice: *Shashi Agro Food v. Andhra Bank IV (2008) BC 294 (AP)*

# Measures to be taken

- Measures against the secured assets
  - Taking possession of the secured assets of the borrower: does it include right to use assets - No*
  - transfer by way of lease, assignment or sale*
  - take over the management of the business of the borrower*
  - appoint a manager to manage the assets possession of which has been taken*
  - require by notice a person who has bought the secured assets to pay for such asset to the lender - this envisages payment for secured assets subject fo fixed charge*
  
- measures u/s 13 (4) limited and cannot be expanded - for example, no power to force a sale without taking possession or management
  
- recover expenses for action u/s 13 (4) - sec 13 (7)

# Measures to be taken (continued)

- proceeding against guarantors/ pledged assets - primary right u/s 13 (11)
- proceeding for balance due under DRTs or competent Court - “as the case may be” implies RDB Act allocation
- Provisions in case of company under liquidation - sec. 529A of Companies Act to be applicable
- Limitation Act applicable - debts barred by limitation cannot be enforced under this law

## Taking Possession u/s 13 (4)

- Purpose of the law is to enforce security interest, not to allow a lender the interest of an asset owner.
- Taking of possession does not amount to transfer of title
- Taking of possession is only for the purpose of realisation of security -
  - *position similar to receiverships under Order 40, rule 1 of CPC*
  - *difference - Civil law receiverships are for preservation of subject matter; this law is for sale*
- Use of reasonable force permitted for possession - *Blade v. Higgs (1861) 10 CBNS 713.*
- Position of lender taking repossession and sale discussed in several English rulings: lender in possession is not a trustee for the borrower



## Taking Possession u/s 13 (4) (continued)

- ❑ Sec 13 (4) to be read with sec 13 (7) - attempts of sale of the asset should follow forthwith upon possession
- ❑ In respect of sale proceeds, the lender is accountable to borrower
- ❑ Lender not allowed to use the asset: all usufructs belong to the borrower
- ❑ Bank cannot take physical possession from the tenant protected under Rent Control Act by invoking the provisions of Sections 13(4) and 14 of the SARFAESI Act, in the event the tenant is in bona fide occupation, thus implying that SARFAESI Act cannot over-ride rent control act.
  - *Indian Bank vs M/S Nippon Enterprises South* ([http://www.indiankanoon.org/doc/645192/.](http://www.indiankanoon.org/doc/645192/)), 2011, Madras High Court.
  - *Pushpangadan v. Federal Bank Ltd.* [(2012) II BC 115 Ker. (FB)]

# Taking over management of business

Right of taking over management also conditioned by the basic purpose of the law - security interest

However, sale of assets is not permissible u/s 13 (6) without taking over possession or management, either of the two is a must

As the purpose of possession is to make a sale, banks may be inclined to avoid difficulties of possession by appointing a manager instead

Nature of the functions of a manager - asset-specific



# Guidelines of RBI on Takeover of Management

- ❑ Change in or Take Over of the Management of the Business of the Borrower by Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines, 2010
  - *Notified on April 21, 2010*
  - *Consolidated in Master Circular dated July 2, 2012.*
  - *Issued u/s 9 of SARFAESI, no guidelines issued u/s 13(4)(b) as yet*
  
- ❑ Takeover of management is only temporary:
  - *Once debts are realised, the management is to be restored back*



# Guidelines of RBI on Takeover of Management (continued)

## □ Preconditions:

- *Minimum amount owed to the lender is 25% of assets of the borrower*
- *At least 75% of lenders agree to taking of action*
- *One or more following circumstances*
  - *Willful default*
  - *Management is acting adversely to the interest of the ARC*
  - *Management is incompetent to run the business*
  - *Borrower has wrongly sold or alienated charged assets*
  - *Reasonable grounds to believe that borrower would be unable to pay*
  - *Has entered into any compromise or arrangement that adversely affects the ARC*
  - *Discontinues or threatens to discontinue business*
  - *Serious disputes have arisen among promoters*



# Usual Objections and Defenses

- Tenancy
  - *Provisions of Transfer of Property Act; protective provisions of the Rent Control Acts of various States*
- Partition or title suit
- Conveyance deed of property was defective/title disputes
- Bank cannot choose properties at its own discretion
- Legality/validity of the security interest
- OTS/restructuring offer
- Legality/service of notice
- Questions on the right to representation

# Manner of sale or transfer of assets

- ❑ Equity of redemption is an important right of a borrower and any clause putting a clog on equity is invalid.
- ❑ Present law gives to the borrower a right to pay within 60 days of notice
- ❑ In addition, at any time before sale or transfer, the borrower may clear his dues and prevent the asset from being sold - sec 13 (8)
  - *This implies the asset cannot be sold without notice to borrower*
  - *borrower has a pre-emptive right to purchase the asset himself*
- ❑ 30 days notice required before sale: Security Interest Enforcement Rules

# Manner of sale or transfer of assets (continued)

- ❑ Also by implication, the sale cannot be made at the back of the borrower:
  - *preferably a public sale*
  - *sale at best price as the borrower gets discharge to the extent of amount paid - sec. 13 (5)*
  - *borrower's right to moneys collected by the seller after appropriation - sec 13 (7)*
  
- ❑ Transferee to get all the rights as if the owner of the assets has transferred the same:
  - *subject to all the equities of the previous owner*
  
- ❑ Can the lender sell the asset to himself - no as implicitly there is a trust between the lender and the borrower; adversary title to beneficiary not permitted



## Priorities and *Pari-passu* Interests

- In case of “financing of a financial asset” by more than one lender, 3/4th sanction in value to be obtained before any or all right u/s 13 (4) is exercised.
  - *Wrong use - should be read as “financing of the secured asset”*
  - *financing of the secured asset cannot be limited to a case where the acquisition of the asset was primarily funded by a lender*
  
- If lenders take such action, their mutual prioritisation not laid down. Rules of sec. 529 of Companies Act and insolvency laws [sec. 61 of Provincial Insolvency Act] to apply on priorities.
  
- Pari passu* rule is an important rule of equity - contracting it out is against public policy -McMillan and Lockwoord 1992 NZ Court of Appeal
  
- Allahabad Bank vs Canara Bank – does it undo the priorities?

# Priorities and *Pari-passu* Interests (continued)

## ❑ Financing of the secured asset confusing:

- *proper meaning is, where security interest on a secured asset held by more than one lender*
- *consent of 3/4th of the lenders required before any action u/s 13 (4)*
- *record date - meaning circular and inconclusive - the date is agreed upon at time when the determination of the date itself requires 3/4 th sanction*
- *3/4th in value refers to “amount outstanding”*
  - *evidence of “amount outstanding” - books of the borrower made evidence*
  - *stone-walling action possible:*
    - *creation of subordinate charges in favour of a friendly lender*
- *question of priorities not at all considered by the law - lenders having subordinate charges put at par with other lenders*

# Priorities between Fixed and Floating Charges

- As a trite law, fixed charges will have a priority over floating charges.
- Determination of “multiple financiers” on an asset has no better answer than charge-holder holding charges.
- The most practical view, therefore, is chargeholders holding fixed charges on the asset need to take a decision (75% voting) on action under sec. 13 (4).
- Floating chargeholders cannot be said to be holding a security interest in the asset until the charge crystallised.
- Will subordinate charge-holders rank equally for voting - apparently yes

# Overriding Preferential Claims

- Provisions relating to preferential claims made applicable only where the company is in liquidation
- where the company is in liquidation, sec 28 (6) of Provincial Insolvency Act saves the rights of the secured creditors.
- This law appropriately overrides. However, subject to preferential claims.
- Appropriately, the provisions should be applicable even where the company is not in liquidation:
  - *sec 123 (1) of the Companies Act requires any receiver to forthwith pay the debts which are preferential claims*
  - *in case of debentures, the provisions of sec 123 shall be applicable notwithstanding the SARFAESI Act*
  - *Sec. 529A of the Companies Act also contains a notwithstanding clause*



## Overriding Preferential Claims (continued)

- Sec 529A - workers' dues and dues of secured creditors take priority over other debts
  
- Leave of Companies Court not required in case of companies under winding up - Allahabad Bank v. Canara Bank (SC)





# Manner and Effect of Takeover of Management u/s 15

- ❑ Amended sec 13 (4) (b) provides of takeover of management; no guidelines framed still
- ❑ Sec 15 clearly exceeds sec. 13 (4).
- ❑ Sec 15 also divergent from the scheme of the SARFAESI Act on enforcement of security: the powers granted under the law can be used only to enforce security and not to run businesses:
  - *Delhi High Court ruling in Micronix India 96 Comp Cas 950 - vestation of proeprty in the SFC only for enforcing security interest*
- ❑ Takeover of management only in case of ARCs and securitisation companies u/s 9.

## Manner and Effect of Takeover of Management u/s 15 (continued)

- ❑ Takeover of assets u/s 13 (4) can only lead to sale of assets - not their running by the lender. Essential rule of foreclosure versus sale
- ❑ Appointment of directors/ administrator to be appointed by the secured creditors
  - *notice in newspapers*
  - *on publication of notice, existing directors shall vacate office*
  - *creditor-directors shall take over the office/ assets*
- ❑ sec 15 (3) overrides the Companies Act.
- ❑ Sec 15 (4) - restoration of management

## Appeal u/s 17

- ❑ Proceedings u/s 17 of the Act are in lieu of the civil suit in the court of first instance under the CPC. – Aas Mohmad v. Punjab National Bank & Anr., I (2009) BC 72 (DRAT)
- ❑ Even when the borrower is aggrieved by the action taken by the secured creditor u/s 13(4) or the borrower is of the belief that the action taken by the creditor is not by law, the only recourse the borrower has through the appeal u/s 17 of the Act, where the DRT is entitled to restore status quo ante – Sumantri Devi v. Canara Bank & Ors., II (2009) BC 511, (Jharkhand HC), the writ petition seeking quashing of issuance of notice u/s 13(2) of the Act not maintainable was dismissed.
- ❑ In Central Bank of India v. State of Kerala & Ors., I (2009) BC 705 (SC) it has been clarified that the communication of reasons to the borrower in terms of Section 13(3A) shall not constitute as the ground for filing application under Section 17(1) of the Act
  - *See also Amba Devi Paper Mills Ltd. v. State Bank of India & Anr [(2012) III BC 425 (DB) Uttarakhand]*

# Time Limit for Appeal u/s 17

- Statute lays a time limit of 45 days
- Kerala High court in J P Jayan's case held that the power to condone the delay is given by the Act
  - *Sec 5 of the Limitation Act is not applicable*
- However, SC in Nahar Industrial Corporation case has held:
  - *In P. Sarathy v. State Bank of India [(2000) 5 SCC 355], this Court opined that although there exists a distinction between a court and a civil court, but held that a Tribunal which has not merely the trappings of a court but has also the power to give a decision or a judgment which has finality and authoritativeness will be court within the meaning of Section 14 of the Limitation Act, 1963.*
  - *Hence, Limitation Act applies to DRTs*
- Hence power to condone delay is applicable.



# Time Limit for Appeal u/s 17 (continued)

## Sec 5 of the Limitation Act applicable-

➤ *UCO Bank v. Kanji Manji Kothari & Co. [(2008) 3 Bom CR 290]; Ponnuswamy and Another v. DRT Coimbatore and Another [2009 (3) Bankers' Journal 401]; State Bank of Patiala v. Chairperson, DRAT & Ors. [(2012) III BC All. 51]; State Bank of Patiala v. The Chairperson, DRAT & Ors. [(2012) II BC All. 212]; Surinder Mahajan vs Debts Recovery Appellate Tribunal & Others [<http://www.indiankanoon.org/doc/127522619/>, decided on 5<sup>th</sup> April, 2013]*

Contradictory view in *Akshat Commercial Pvt. Ltd. & Anr. v. Kalpana Chakraborty & Ors. [IV (2010) BC 267 Cal. (DB)]*

# Application to DRT

- Surprisingly, number of “secured creditors” may not come under DRT jurisdiction, but appellate powers conferred on DRTs.
- Appeal within 45 days of “measures having been taken”
- Jurisdiction - jurisdiction under sec. 19 (1) of DRT law is based on the borrower’s residence
- Cannot do away with powers of making an appeal even before the measures are taken.
- Sec 19 (12) allows DRT to order injunction

# Application to DRT (continued)

- Deposit of 75% of the notice amount
  - *DRTs may reduce amount to be deposited*
  - *Similar condition under RDB law upheld in Anant Mill vs State of Gujarat 1975 SC*
  - *notice amount to be borne out by records of the lender*
  
- Appeal to Appellate Tribunal within 30 days
  
- The appellate authorities may hold the possession unauthorised and order compensation.

## Application to DRT/ DRAT

Section 17(5) prescribes the time limit of sixty days within which an application made u/s 17 is required to be disposed off. The proviso to the sub-section envisages extension of time upto four months for adjudication of the application

The Co-operative Banks cannot initiate proceeding under the provisions of SARFAESI Act or approach DRT, being aggrieved, as co-operative banks are consciously excluded from the purview of RDB Act – *Sri Basaveshwar Co-operative Bank ltd & Anr. v. Umesh & Ors.*, I (2009) BC 21 (DRAT)



# Who can file an Appeal?

- ❑ In *S Shalini vs DRT*, ruling dated 17 April 2009, Madras High court held that a shareholder of the company did not have a right to bring petition under sec 17.
  
- ❑ “Any person” is of wide import. It takes within its fold, not only the borrower but also the guarantor or any other person who may be affected by the action taken under section 13(4) or section 14 of the Act.
  - *United Bank of India v. Satyawati Tandon and Others [III (2010) BC 495 (SC)]*
  
- ❑ A lessee in respect of a part of the entire property dragged into the main dispute between the land owner and the bank, was held to be a “person aggrieved” for the purpose of Section 17(1)
  - *Hindustan Petroleum Corporation Ltd. v. Debts Recovery Tribunal & Ors. [(2012) IV BC 737 Ori.(DB)]*

# Powers of DRT

- ❑ In *Nahar Industrial Enterprises Ltd v. Hong Kong & Shanghai Banking Corporation* (SC ruling, date of judgment – 29/7/2009) jurisdiction of the DRT is discussed and the following questions were addressed
  - *Whether the High Court/ Supreme Court has the power to transfer a suit from Civil Court to DRT?*
  - *Whether Article 142 is applicable to direct a transfer from a Civil Court to DRT*
  - *Whether High Court had the power to transfer a counter-claim to the DRT?*
  
- ❑ It was held that civil courts and courts trying disputes of civil nature are two different and that Tribunal cannot be treated as a court. The Tribunal was constituted with the specific purpose and can issue a certificate for recovery of dues and cannot pass a decree.

## Powers of DRT (continued)

- ❑ The Tribunal is not bound by the procedures laid down in the Code and it may evolve its own procedure subject to the compliance of the principle of natural justice.
- ❑ It was held that the powers of the court under Articles 139A and 142 of the Constitution are wide and extensive and may be resorted to do complete justice.
- ❑ Relying on several other cases, it was held that a counter-claim can be transferred to the Tribunal when the subject matter of the suits of the plaintiff and the defendant are inextricably connected and both parties place their consent for the same.

## Powers of DRT (continued)

- ❑ In Transcore, SC has held that DRTs are a creature of the statute and do not have the inherent powers enjoyed by civil courts.
- ❑ In Nahar Industrial, SC has further curtailed the powers of DRTs
- ❑ DRT only required to consider the question of validity of actions taken by the secured creditor, and is not required to adjudicate the exact amount of debt due to secured creditor
  - *Canara Bank v. Supreme Ceramics Ltd. [(2012) III BC 3 (DRAT-Delhi)]*
- ❑ There is no provision in the SARFAESI Act which enables the opposite party to make a plea of set-off or counter-claim in the DRT. The DRT while exercising power under the SARFAESI Act has no jurisdiction to entertain suits even in the nature of cross-suits.
  - *Jose Antony v. Anil Kuruvilla Kattottil & Ors [(2012) III BC Ker. 635 ]*

## Applicability of SARFAESI Act in case of companies under winding up

- ❑ SC ruling in Allahabad Bank Vs. Canara Bank 2000 (4) SCC 406 - rights of DRT override the jurisdiction of the winding up court.
- ❑ However, in Rajasthan State Financial Corporation Vs. The Official Liquidator 2005 (8) SCC 190, SC held that in case of companies in winding up, the liquidator has to be associated
- ❑ Key principles enunciated by the SC in Rajasthan State Finance Corporation case:
  - 1) *DRT entitled to order the sale and to sell the properties of the debtor, even if a company in liquidation, through its Recovery Officer but only after notice to the Official Liquidator or the Liquidator appointed by the Company Court and after hearing him.*
  - (2) *Similarly, a District Court entertaining an application under Section 31 of the SFC Act will have the power to order sale of the assets of a borrower company in liquidation, but only after notice to the Official Liquidator or the Liquidator appointed by the Company Court and after hearing him.*



## Applicability of SARFAESI Act in case of companies under winding up (continued)

- *(3) A financial corporation acting under Section 29 of the SFC Act seeks to sell assets of a company in liquidation can do so only after permission from the Company Court, and as per directions of the Company court;*
  - *(4) In a case where proceedings under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 or the SFC Act are not set in motion, the creditor concerned is to approach the Company Court for appropriate directions regarding the realisation of its securities consistent with the relevant provisions of the Companies Act regarding distribution of the assets of the company in liquidation.*
- In other words, a company in liquidation becomes a special case in light of the distribution principles set out in the Companies Act
- Following SC ruling in Rajasthan State Financial Corporation, in Asset Reconstruction Company (India) Limited Vs The Official Liquidator 2006 (3) SCC 529, DB of Madras High court sale by a secured creditor under SARFAESI also subject to leave of court

# Major Amendments in the SARFAESI Act: Snapshot

- ❑ A multi-State co-operative bank included in the definition of “bank” u/s 2(c)
- ❑ Section 5(5) inserted: Post-acquisition of financial assets, u/s 5, the SC/ARC may file application to DRT/DRAT/any Court/other authority for substitution of its name in any pending suit, appeal or other proceedings
  - *Consent of originator required*
  - *DRT/DRAT/any Court/other authority to pass order for such substitution*
- ❑ Measure added under Section 9: Conversion of any portion of debt into shares of borrower company allowed.
  - *Retrospective: any conversion made prior to the amending Act is valid.*





# Major Amendments in the SARFAESI Act: Snapshot (continued)

- ❑ Time limit for communicating reasons u/s 13(3A) increased from 1 week to 15 days.
- ❑ An officer, if authorised by the secured creditor, can bid on behalf of secured creditor for the immovable property, if the prior sale was postponed due to want of bid of an amount not less than such reserve price [Sec. 13(5A) inserted]
- ❑ In case the purchaser is the authorised himself, the purchase price to be adjusted towards the amount of claim [Section 13(5B) inserted]
- ❑ Section 9 of the Banking Regulation Act, 1949 shall, as far as may be, apply to the immovable property acquired by secured creditor . [Section 13(5C) inserted]. The Banking Regulation Act, 1949 restricts holding of any immovable property, allows:
  - *Holding for own use*
  - *Or, in other cases, for a max. of 7 years.*



# Major Amendments in the SARFAESI Act: Snapshot (continued)

- Joint financing u/s 9: Value decreased from 75% to 60% for initiating action-easier than before.
  
- Sec14: Role of CMM/DM enhanced
  - *To be satisfied as to the contents of the affidavit required to be filed by the secured creditor, before passing orders*
  - *Prospective: Not to apply to proceedings pending at the commencement of the amending Act*
  - *Delegation allowed.*
  
- Section 18C inserted: Right to lodge a caveat
  
- Power to CG to notify that all transactions of securitisation, or asset reconstruction or creation of security interest subsisting on or prior to the date of establishment of the Central Registry to be registered

# Major Amendments in the SARFAESI Act: Snapshot (continued)

## Cognizance of offences (u/s 30)

- *No court to take cognizance of offences punishable under section 27 , except on a written complaint by an officer of Central Registry/RBI*

## Sec 31A inserted: Wide powers to CG

- *to exempt class(es) of banks/FIs from any of the provisions of the Act totally;*
- *To apply any of the provisions of the Act to such class(es) of banks/FIs with modifications, exceptions, adaptations*
- *Notification to be in public interest*
- *Draft of the notification to be laid in both the Houses of Parliament*



**Thank You**