SARFAESI Act action: Abatement of references to BIFR

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It sounds like saying – if a patient is sick and is being nursed in a hospital, and in the meantime, a virus attacks the patient, the doctor must stay away, and once the viruses have almost killed the patient, the doctor has nothing to do – hence, he must stay away anyways! This is the strange position that any person with the slightest idea of enactment of the Sick Industrial Companies law may laugh at, but is seemingly the scenario after enactment of second proviso to section 15 (1) of the Sick Industrial Companies Act (SICA).

SICA is a quasi bankruptcy law, and was enacted on lines of Chapter 9 of the US Bankruptcy Code. Similar provisions in laws of other countries are fairly common – reorganization provisions of US Insolvency Act, for instance, provide for revival of a bankrupt but potentially viable undertaking. As a matter of fact, sections 391-393 of the Companies Act were also originally intended for revival of sick companies – that is why section 390 provides that these sections are meant for restructuring of a company liable to be wound up under the Act[1].

SARFAESI Act, on the other hand, was enacted for speedier enforcement of security interests, that is, charges, by banks and financial institutions. The Act was also modeled on US Article 9 of the UCC and laws relating to security interests on personal property in many other countries, but unlike global practice, the law was kept limited to enforcement of security interests by banks and financial institutions. As a result, it because the twin brother of the other law on enforcement of bankers' claims – the RDB Act, the difference being that SARFAESI Act is concerned only with enforcement of security interests, whereas RDB Act extends to enforcement of any claim by the bank. In that sense, the RDB Act is far wider in scope, but being based on involvement of a judicial authority, viz., the DRT, bankers have found it time-taking. So, the latest idea of direct action against the culprit – almost in tune with Bollywood formula films – seems to be working much better than rendition of justice by judicial or quasi-judicial authorities. Justice is time-taking; hence, justice may dispsensed with!

[1] It is a different story that Indian courts have, apparently driven by concerns of widening the realm of these sections, interpreted the phrase "liable to be wound up" to include every company, because every company that is incorporated under the law may, at some stage, be wound up under the law. Resultingly, these sections are used more by healthy companies than by sick companies.

Bankruptcy laws and creditor-driven debt recovery laws obviously work at cross purposes. The idea of bankruptcy laws is rateable distribution. Banrktupcy is obviously a case of shortfall of assets over liabilities. In such a situation, if the rule of might-is-right prevails, there would be absolute anarchy, and complete denial of fair opportunity to those creditors who have not used coercive means of recovery. Hence, as an essential principle, bankruptcy laws provide for cessation of direct action against assets of the bankrupt, and provide for administration of the distribution of assets by a court-appointed administrator, liquidator or bankruptcy trustee. Hence, bankruptcy laws almost invariably provide for stay on action by creditors against the bankrupt-debtor.

Such a stay against enforcement actions by creditors is all the more understandable in case of a bankrupt-but-viable, that is, sick-but-not-morbid debtor, because the very premise of sickness relief is that the entity may be restored back to health. If, even while someone is working on revival of a sick company, creditors are allowed to attach assets and sell them, the very basis of revival does not remain. Hence, if creditors are allowed to seize and sell assets, that would strike at the very root of the revival proceeding.

In India, as SARFAESI Act was passed, a primacy was given to the SARFAESI Act proceedings. That is, even if sickness revival proceedings were going on, a secured creditor could still seize and sell assets without the intervention of any judicial authority, not to speak of the BIFR. This itself, in principle, is highly strange. The moratorium put on the seizure of assets by creditors during revival proceedings is not something that creditors are happy about. In fact, if creditors are taken as vultures, the moratorium is to keep the vultures away, as the entity is sick and not dead. If a creditor is allowed to seize and sell assets, then the very hope of revival goes away, and the very basis on which rehabilitation exercise is presided over by BIFR gets frustrated.

To make matters worse, a proviso was inserted under sec 15 (1) [this became the second proviso under sec. 15 (1)] to say that if secured creditors representing 75% or more of the financial assistance availed by the borrower have taken one or more measures under sec. 13 (4) of the SARFAESI Act, then the reference shall abate.

Since SICA in essentially intended for industrial units, there is hardly any case of a sick company under SICA, which does not have loans from banks and financial institutions. Therefore, there is hardly any borrower who is under the SICA, and still would not face SARFAESI Act action. This would mean, exactly opposite to the benevolent jurisdiction of the BIFR, sick companies face the discretion of the secured lenders – it is only where the lenders want the unit to revived rather than killed that SARFAESI Act action shall not be taken, and therefore, the abatement of reference as envisaged by second proviso to sec 15 (1) will not follow. The primacy of SARFAESI Act to SICA is completely a mistaken legislative measure, and goes against the very spirit of bankruptcy or quasi-bankruptcy laws.

What is meaning of the reference abating? Abatement of a reference reads in the same rhythm as"abatement of a suit" as used in several places in Order XXII of the CPC. **Black's Dictionary** defines the word to mean the same as nullifying, eliminating or suspending. There are several court rulings that have examined the meaning of the expression abatement of a suit – it means complete overthrow of a case, a complete termination of all proceedings. Abatement is not the same as stay – stay is a temporary cessation of proceedings, whereas abatement is complete end thereof.

This meaning of the word "abatement" seems appropriate in context of second proviso to section 15 (1) of SICA. Once creditors who have lent as much as 75% of the loans to a sick company have taken away the assets, there is nothing really left in the sick company to be revived. Hence, it is appropriate that the reference must get completely obliterated – whether it was pending or the company has already been declared sick.

In *Ravi Spinning Ltd. And Ors. vs Union Of India (Uoi) And Anr.* 2006 (2) MhLj 145 a Division Bench of the Bombay High court that the reference having been abated, the matter gets completely dissolved, and there is nothing for the BIFR to do thereafter.

The Orissa High Court in *Noble Aqua P Ltd and others v. State Bank of India and others* AIR 2008 ORISSA 103 tried to draw a distinction between a case where the reference is pending, and one where the unit has already been declared sick. As per the Orissa High court, the question of abatement of reference would not arise where the unit had already been declared sick, as there is no pendency of reference in such a case. The ruling has been referred to and not disputed in *Kanakadhara Spinning Mills (P) Ltd*. v. *BIFR* , ruling dated 23rd July 2009, http://www.indiankanoon.org/doc/765303/ . The Delhi High court in Punjab National Bank And Ors. vs Aaifr And Ors. on 26/5/2008, http://www.indiankanoon.org/doc/94829/ dissented from the ruling of the Orissa High court and held that even if proceedings had been taken on declaration of sickness, the second proviso to sec. 15 (1) will still prevail. A Division Bench of the Calcutta High court in *Imperial Tubes (P) Ltd. And Anr. vs Board For Industrial And Financial Reconstruction And Ors.* on 12/10/2007 AIR 2008 Cal 15 did not discuss the ruling of the Orissa High court, but strangely enough, in this case, one of the secured creditors who seized and sold the assets of the borrower under sec. 13 (4) of the SARFAESI Act was also the operating agency. Continuing our metaphor of the sick company being the patient, BIFR being the doctor, and operating agency being the nurse, it amounted to saying that the nurse could kill the patient, and the doctor would not interfere !

Courts are not policy makers. Courts do not write the law, neither do they write legislative policy. The law is handed over to the courts – at best, courts may only try to find a hole or two to impart some sense in the laws. In the present case, Orissa High court's ruling is not of much relief to borrowers – several borrowers in respect of whom Orissa High court ruling would be applicable are showing as "abated" status on the BIFR website. In other words, BIFR has clearly taken the view that secured creditors may go-grab the assets of their respective borrowers, with the BIFR looking the other side, and once that is done, the BIFR is left with nothing to do.