Secured loans: Can Lenders Help Themselves?

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Law on foreclosure procedures and self-help repossession is one of the highly-talked-about issues currently. With the subprime crisis, mortgage foreclosures have gone up in the US. The global recession that has resulted therefrom has caused a sharp increase in rate of consumer defaults, on mortgage loans and other asset-backed loans. In result, foreclosure rates have gone up sharply in most countries.

There several words used in connection with foreclosures – foreclosure, repossession, sequestration, replevin, attachment, receivership, etc. There are several agencies talked about – bailiffs, repo men, recovery agents and so on.

A brief familiarization with the jargon. **Repossession** means the same as its literal meaning – gaining possession of an asset. **Foreclosure** is a word commonly used in connection with mortgages: in a mortgage, the mortgagor (borrower) has the right to get back his property mortgaged to the lender. Such right is called right of redemption. Due to default on terms of a loan, the lender cancels the mortgagor's right of redemption: this is called foreclosure. In practice, the word foreclosure is used in the same sense as repossession.

The word **attachment** in legal parlance is a restraint on property - usually, attachment means the property has been taken in judicial custody and cannot be sold or dealt with by the owner. Attachment usually arises by operation of law or by order of a judicial authority.

The words **sequestration** and **replevin** are commonly used in US legal circles, meaning seeking of repossession through a judicial order. Usually the word is used for personal, that is, movable property only.

Receivership is commonly used in UK and similar jurisdictions, as a person appointed by the court to cause a property to be attached, sold and receive its proceeds or rentals. Receiverships are quite common in bankruptcy proceedings, or upon enforcement of floating charges as in case of debentures.

The word **repo man** is commonly used in US as the agencies that help in self-help repossession – the same as **recovery agents** in India. **Bailiffs** are institutional agencies created by legal systems of some countries to hold custody of assets, sell assets, etc. Certificated bailiffs exist in the UK, Canada, and to some extent, in USA too.

Repossession law in the USA:

The law on repossession of secured transactions is contained in Article 9-609 of the Uniform Commercial Code (UCC) in the USA. Article 9-609 provides that a secured party may take repossession of the collateral, either judicially, or non-judically. In case of

non-judicial repossession, the pre-condition laid by law is that the repossession should proceed "without breach of peace". Article 9-603 provides that parties cannot, by contract, define the standards of breach of peace – this is to ensure that lenders do not force borrowers to contract out of the generally acceptable meaning of breach of peace.

Similar provisions are contained, in case of financial leases, in Article 2A-525.

The previous version of this provision [Art 9-503] contained elaborate definition of what may be regarded as "breach of peace". In the revised version, those illustrations and elaboration was dropped. The official commentary to Article 9-609 provides that "Like former section 9-503, this section does not define or explain the conduct that will constitute a breach of the peace, leaving that matter for continuing development by the courts. In considering whether a secured party has engaged in a breach of the peace, however, courts should hold the secured party responsible for the actions of others taken on the secured party's behalf, including independent contractors engaged by the secured party to take possession of collateral".

On what is breach of peace, there have been lots of cases from out of most of the States in the USA. Several of these cases, State-wise, are cited in http://www.rsig.com/leading_caselaw.html. Most of the rulings are facts-and-circumstances rulings. However, in some cases, courts have tried to lay down general principles to decide what is breach of peace. Quite obviously, no repossession can be a happy parting celebration for the defaulting debtor – so, his peace is surely going to be breached. But the meaning of "breach of peace" is not not-being-offensive to the debtor, but to cause a public breach of peace or violence. In an articulate Illinois case *Chrysler Credit Corp. v. Koontz*, 277 Ill. App. 3d 1078, 661 N.E.2d 1171 (1996), it was held that the term "breach of peace" "connotes conduct which incites or is likely to incite immediate public turbulence, or which leads to or is likely to lead to an immediate loss of public order and tranquility. Violent conduct is not a necessary element. The probability of violence at the time of or immediately prior to the repossession is sufficient." Courts should Courts should "apply the statute in a way that reduces the risk to the public associated with extrajudicial conflict resolution."

In *Davenport v. Chrysler Credit Corp.*, 818 S.W.2d 23, 30 (Tenn. App. 1991), a Tennessee court held that "public policy favors peaceful, non-trespassory repossessions when the secured party has a free right of entry" and "forced entries onto the debtor's property or into the debtor's premises are viewed as seriously detrimental to the ordinary conduct of human affairs." *Davenport* recognized that the secured creditors' legitimate interest in obtaining possession of collateral without having to resort to expensive and cumbersome judicial procedures must be balanced against the debtors' legitimate interest in being free from unwarranted invasions of their property and privacy interests. "Repossession is a harsh procedure and is, essentially, a delegation of the State's exclusive prerogative to resolve disputes. Accordingly, the statutes governing the repossession of collateral should be construed in a way that prevents abuse and discourages illegal conduct which might otherwise go unchallenged because of the debtor's lack of knowledge of legally proper repossession techniques."

Position in India:

In India, foreclosures in case of mortgages are governed by the Transfer of Property Act. For most mortgages, foreclosure is not permitted without a civil decree, which is quite a time-taking process. In case of movable property, there has not been any codified law: hence, the general belief has been that the contract between the parties will prevail. There have been several rulings upholding the right of the creditor to repossess assets without the interference of courts – these are discussed below.

The SARFAESI Act, presumably modeled on the style of Article 9 of UCC, made an exception to provide for self-help repossession remedy in case of banks and financial institutions. It is not that the self-help remedy provided by SARFAESI Act was unique – there are similar non-judicial powers granted under the SFC Act, IDBI Act, IFCI Act, SIDBI Act, etc. But the sweep of the SARFAESI Act is wide enough to cover all banks and financial institutions – it is, therefore, one of the most significant measures towards self-help repossessions.

The changing scene of non-judicial repossessions:

Outside of the SARFAESI Act, does a lender, conferred with a power to repossess asset on default of a secured loan, have a right to do so without intervention of a court? The question is quite significant, but the question has not been addressed by Indian laws all this while, and unfortunately, SARFAESI Act also makes scanty provisions only.

Years ago, in *State of India* v *S B Shah Ali* 1995 AIR (AP) 134, the AP High Court discussed the nature of hypothecation as purely a matter of contract. It held that if a contractual right to repossession is provided, there is no need for court to interfere. The court held: "Intervention of the Court is not necessary and compulsory for enjoyment of a right , and the intervention of Court arises only when there is an infringement of right, and when there is no infringement, there is no lis and no suit. In the hypothecation agreement, the rights of the hypothecatee are governed by the terms of the agreement. Where the agreement provides for taking of possession of the goods hypothecated, the hypothecatee can take possession of the said goods without intervention of the Court".

There are several other rulings supporting this view: see, for instance, Imphal Bench of Gauhati High court in *Manipur Industrial Development Corpn vs Maiban Khogen Singh*, 2003 ruling; Kolkata High Court in *Arindam Basu And Ors. vs Amal Kumar Bose And Ors.*, 2006.

In *Managing Director, Orix Auto Finance vs. Jagmander Singh*, II (2006) BC 108 (SC), the Supreme Court gave a ruling on the right of repossession. Notably, this case is one of hire purchase, but generic observations were made by the Apex court on contractual agreement). The Supreme court held:

> "Essentially these (right of repossession) are matters of contract and unless the party succeeds in showing that the contract is unconscionable or opposed to public policy the scope of interference in writ petitions in such contractual matters is practically non-existence. If agreements permit the financier to take

possession of the financed vehicles, there is no legal impediment on such possession being taken."

The Court also held that High courts cannot lay down any practices in this regard.

Contrary views have been expressed by certain courts. In case of *Tarun Bhargava Vs. State of Haryana & Anr*. AIR 2003 P&H 98 High court, it was held that "If the agreement is held to be a loan agreement and rights of the creditor are held to be those of a hypothecatee, rights of the parties under the agreement would be different. A hypothecatee, cannot take possession of the security without intervention of the Court, though he has a right to take possession or to sell the hypothecated property through Court or to give notice to the hypothecator to enforce the security. Permitting a hypothecatee to physically repossess the hypothecated goods against the wishes of the hypothecator will enable the hypothecatee to take law in his own hands, deprive the hypothecator of his defence by depriving him of the use of goods even when his claim may be that he does not owe any money….." Kerala High Court in *Shibi Francis vs. State of Kerala And Anr*., 2006, Punjab- Haryana High Court *in Narinder Kumar Singla vs State Of Punjab And Anr., 2006,* Kolkata High Court in case of *Ashok Kumar Singh v. State of West Bengal and Ors.*, 2003 also hold the same view.

Repossession practices:

While the rulings of courts noted above were on the power of repossession, the practical aspect of repossession – how exactly does the lender go-grab the asset, was not discussed in any of the rulings cited above. The biggest challenge in self-help repossession, obviously, is that the no repossession can be a pleasant exercise for the borrower: therefore, every borrower would put up as much resistance as he can. Corporate borrowers being more resourceful legal recourse to the courts - something that they have been doing over the years, as evident in the countless rulings of courts. In case of retail borrowers, the resistance is more physical than juridical. Obviously therefore, lenders cannot repossession retail assets themselves - they engage agencies for doing so.

The practice of engaging agencies for repossession became common as banks aggressively embarked on retail financing. Developmental banks of yesteryears became dream merchants financing cars, cards, and what all. The recovery agents specialized in the job of repossession – which obviously meant they would have both legal and extra-legal resources under their common. Much like the excesses often committed by the police force, the recovery agents are often tough in their approach. Several instances of forcible repossession of assets, mainly, cars and lorries, went to courts.

In one of the leading cases, in *ICICI Bank Vs. Prakash Kaur & Ors*., (2007) 2 SCC 711; II (2007) BC 226 (SC), the Supreme Court talked about "procedure recognized by law" without amplifying what that procedure was. To quote: "Before we part with this matter, we wish to make it clear that we do not appreciate the procedure adopted by the Bank in removing the vehicle from the possession of the writ petitioner. The practice of hiring recovery agents, who are musclemen, is deprecated and needs to be discouraged. The Bank should resort to procedure recognized by law to take possession of vehicles in cases

where the borrower may have committed default in payment of the instalments instead of taking resort to strong-arm tactics". On reading of the case, it is clear that the Ld Judges were vehemently against credit card lending practices of banks, mainly slapping unexplained charges, though the present case was not one of credit card. In this case, Justice Lakshmanan made several suggestions about guidelines on recoveries.

In *ICICI Bank vs Shanti Devi Sharma* III (2008) BC 453 (SC), there were allegations of deployment of musclemen, which was held as illegal. The High Court in its order had noted that the apparent cause of borrower's son's suicide was the recovery action taken by the bank. The wanted this observation to be expunged from the order of the Court. The Supreme Court refused to oblige.

In a Delhi High court ruling in **Dr.Amitabh Verma Vs. Commissioner of Police & Ors. 100 (2002) DLT 581**, the case was one of a borrower who was a reputed doctor. It was alleged that the doctor was pushed out of car which was repossessed. While deprecating the action, the Delhi High court framed "general guidelines".

There have been several NCRDC orders too.

The Calcutta High court has maintained a general stance that self-help repossession by a lender is permissible. In *Palash Chatterjee vs State Of W.B. And Anr*. decided on 20/6/2007, the High Court held on the right of recovery (a case of hire purchase), but then did not dwell on the practices. Instead, the court held: Whether the mode of recovery of the vehicle was just or what should be the mode of recovery of the vehicle is not the question before me and what was agitated is that the complainant was allegedly cheated by the petitioner and that the latter allegedly misappropriated the money. This question has been answered in the body of the Judgment arid I am of the opinion that on the facts of the case the offence under Section 406/420 of the IPC has not been made out where the complaint does not disclose ingredient of the aforesaid offences."

In a recent ruling in the case of GE Capital, ruling dated 31st March 2009, the Calcutta High court has once again held that lenders may repossess assets if instalments are not paid.

Conclusion:

Breach of peace is a significant restraint on the rights of a lender in the freest of free markets. Indian law on this issue remains vague – benefiting none except the lawyers. The machinery of the SARFAESI Act has now been tried for quite some time – instead of letting lenders rely on powers under the loan agreement, it may be useful to consider whether SARFAESI Act may be extended to private lenders too.