# RIGHTS OF DEBTOR UNDER SARFESI ACT, 2002

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## Background

To fight the menace of growing non-performing assets and on the basis of recommendations of Andhyarujina committee, SARFESI Act, 2002 was enacted. Many of legal experts believe that this act is draconian, devoid of the principal of natural justice and one-sided in nature. This act was enacted on the believe that the normal process of recovery of debts through courts is lengthy and time taken is not suited for recovery of such dues. For financial assistance rendered to the industries by the financial institutions, financial liquidity is essential failing which there is a blockade of large sums of amounts creating circumstances which retard the economic progress followed by a large number of other consequential ill effects. So, the Recovery of Debts Due to Banks and Financial Institutions Act was enacted in 1993 on the basis of recommendations of Narasimham Committee but as the figures show it also did not bring the desired results. In the present day global economy it may be difficult to stick to old and conventional methods of financing and recovery of dues. So, the bank and the financial institutions cannot afford a delay in the recovery process. The bank and financial institutions cannot afford that a significant portion of the funds remains blocked in unproductive assets, the values of which keep deteriorating with the passage of time along with incurring substantial amounts of expenditure by way of legal. It is, therefore, justified that Banks and Financial Institutions should be given a stringent law with substantial power of recovery without any procedural Delay.

But certainly, what must be kept in mind is that the law should not be in derogation of the rights which are guaranteed to the people under the Constitution. The procedure should also



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be fair, reasonable and valid, though it may vary looking to the different situations needed to be tackled and object sought to be achieved. A law has to meet the constitutional obligations and the concept of equitable justice. The constitutional Validity of this law has been questioned thrice and in all three cases, the Supreme Court has upheld the validity of this act. However, various high courts and Debt Recovery Appellate Tribunal have developed rights of the debtor in different cases. This Act was challenged in Mardia Chemicals Ltd., primarily on the ground that Banks and Financial Institutions have been vested with arbitrary powers without any guidelines for their exercise and also without providing any appropriate and adequate mechanism to decide the disputes relating to the correctness of the demand, its validity and the actual amount sought to be recovered from the borrowers. It was also questioned that absence of judicial forum will be against principles of natural justice. However, the Supreme Court has upheld the constitutional validity of this act and observed that "the borrowers would get a reasonably fair deal and opportunity to get the matter adjudicated upon before the Debt Recovery Tribunal. The effect of some of the provisions may be a bit harsh for some of the borrowers but on that ground the impugned provisions of the Act cannot be said to be unconstitutional in view of the fact that the object of the Act is to achieve speedier recovery of the dues declared as NPAs and better availability of capital liquidity and resources to help in growth of economy of the country and welfare of the people in general which would subserve the public interest."[1]

Again in the case of *M/S Transcore v Union of India*, this Act was challenged on various grounds and it was held by the Supreme Court that both DRT Act ( Recovery of Debt Due to Bank and Financial Institution Act, 1993) and this Act are supplementary and complimentary enacted for the purpose of speedier recovery of debt due to banks and financial institutions.[2]

Further, in the case of *Kanaiyalal Lalchand Sachdev v. State of Maharashtra*, ,the Supreme Court held that "The intention of the legislature is, therefore, clear that while the banks and financial institutions have been vested with stringent powers for recovery of their dues, safeguards have also been provided for rectifying any error or wrongful use of such powers by vesting the DRT with authority after conducting an adjudication into the matter to declare

[1] *Mardia Chemicals v Union of India, AIR* 2004 *SC* 2371 .
[2] *M/S Transcore v Union of India*,AIR 2007 SC 712.



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any such action invalid and also to restore possession even though possession may have been made over to the transferee." [3]

So, in different cases, courts have tried to establish the balance between the rights of the debtor with ensuring safeguards required against vast powers given to the banks and financial institutions under this Act.

## Regulatory framework of recovery Under SARFESI Act, 2002

Under this Act, firstly a debt is required to be classified as nonperforming assets in accordance with RBI guidelines on classification of standard assets.

Thereon, a notice is required to be given to debtor under sec 13(2) of this act. It says that "Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under subsection (4)". [4] So, the debtor is required to discharge his liabilities within 60 days receiving of this notice, failing which creditor is entailed to exercise extreme options under Sec 13(4), which may include taking the possession and sale of the secured assets.

A debtor can make any raise many objections with the creditor within the time period of 60 days. Those objections must be decided by the banks before applying extreme measures after 60 days. However, in the event of non-payment by the debtor and after the expiry of sixty days Banks and Financial Institutions are empowered to invoke sec 13(4) of this Act. It says that " In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:-- (a) take possession of the secured assets of

[3] *Kanaiyalal Lalchand Sachdev v. State of Maharashtra* ,(2011) 2 SCC 782.
[4] SARFESI Act, 2002, Sec 13(2).



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the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset; (b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset: PROVIDED that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt: PROVIDED FURTHER that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt. (c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor; (d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt."[5]

So, the extreme powers have been given under Sec 13(4) of the act to recover the secured assets. The debtor cannot file any appeal under Sec 17 of the Act to Debt Recovery Tribunal (Hereinafter referred as DRT) . An appeal can only be filed after taking of measures under Sec 13(4) of the Act. So, before taking the measures, Debtor can only raise objections with the Banks and Financial institutions, which are the party to the dispute. Courts except High Court and Supreme Court can not intervene before taking of measures otherwise on the basis of extraordinary writ jurisdiction.

The debtor position appears to be disadvantageous at first sight vis a vis the bank and financial institutions. However, the courts have developed the limited jurisprudence in the favour of the debtor.

**Rights of the debtor**

Debtor has been defined under this act as "borrower" means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a

[5] *Ibid*, Sec 13(4).



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securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance" [6]So, debtor and guarantor have been put under the similar obligations by enlarging the definition of debtor including guarantor. The following important rights have been evolved by the courts in different cases.

**Reasonable classification of debt as NonPerforming assets followed by notice under Sec 13(2)**

The first important point with respect to the debtor is a classification of his loan as non-performing assets by the bank in a reasonable manner. Unless a debt is classified as nonperforming assets under relevant RBI guidelines, this act is not applicable.

In the case of *Mardia Chemicals v Union of India*, it was held that "Banks should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high-value accounts. The banks may fix a minimum cut-off point to decide what would constitute a high-value account depending upon their respective business levels. The cut off point should be valid for the entire accounting year."[7]

It was further held that "Responsibility and validation levels for ensuring proper asset classification may be fixed by the banks. The system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extant guidelines."[8] So, the classification has to be done reasonably under the RBI guidelines.

After classification of debt as non-performing assets, only the notice can be served to the debtor under Sec 13( 2) the Act.

**Adjudication of objections in a reasonable manner and reasonable time**

[6] *Ibid*, Sec 2 f.
[7] *Supra Note 1* .
[8] *Ibid.*



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It was held in the case of *Mardia chemicals* that "The creditor must apply its mind to the objections raised in reply to such notice and an internal mechanism must be particularly evolved to consider such objections raised in the reply to the notice. There may be some meaningful consideration of the objections raised rather than to ritually reject them and proceed to take drastic measures under sub-section (4) of Section 13 of the Act. Once such a duty is envisaged on the part of the creditor it would only be conducive to the principles of fairness on the part of the banks and financial institutions in dealing with their borrowers to apprise them of the reason for not accepting the objections or points raised in reply to the notice served upon them before proceeding to take measures under sub-section (4) of Section 13."[9]

In the case of *M/S Transcore v. The Union of India and another,* It was held that ".After classification of an account as NPA, the last opportunity is given to the borrower of sixty days to repay the debt. Section 13(3-A) inserted by amending Act 30 of 2004 after the judgment of this Court in Mardia Chemicals (supra), whereby the borrower is permitted to make representation/ objection to the secured creditor against the classification of his account as NPA. He can also object to the amount due if so advised. Under Section 13(3-A), if the bank/FI comes to the conclusion that such objection is not acceptable, it shall communicate within one week the reasons for non-acceptance of the representation/objection."[10]

**Communication of rejection of objections**

After deciding the objections in a reasonable manner, it should be communicated to the debtor properly. The purpose here is to provide a principle of natural justice to the debtor.

In the case of *Mardia chemicals* , it was held that " Such reasons, overruling the objections of the borrower, must also be communicated to the borrower by the secured creditor. It will only be in fulfillment of a requirement of reasonableness and fairness in the dealings of institutional financing which is so important from the point of view of the economy of the country and would serve the purpose in the growth of a healthy economy. It would certainly

[9] *Ibid.*
[10] *Supra* Note 2.



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provide guidance to the secured debtors in general in conducting the affairs in a manner that they may not be found defaulting and being made liable for the unsavoury steps contained under sub-section (4) of Section 13. At the same time, more importantly, we must make it clear unequivocally that communication of the reasons not accepting the objections taken by the secured borrower may not be taken to give an occasion to resort to such proceedings which are not permissible under the provisions of the Act. But communication of reasons not to accept the objections of the borrower, would certainly be for the purpose of his knowledge which would be a step forward towards his right to know as to why his objections have not been accepted by the secured creditor who intends to resort to harsh steps of taking over the management/business of viz. secured assets without intervention of the court. Such a person in respect of whom steps under Section 13(4) of the Act are likely to be taken cannot be denied the right to know the reason of non- acceptance and of his objections. It is true, as per the provisions of the Act, he may not be entitled to challenge the reasons communicated or the likely action of the secured creditor at that point of time unless his right to approach the Debt Recovery Tribunal as provided under Section 17 of the Act matures on any measure having been taken."[11]

It was further held that " We are holding that it is necessary to communicate the reasons for not accepting the objections raised by the borrower in reply to notice under Section 13(2) of the Act more particularly for the reason that normally in the event of non- compliance with notice, the party giving notice approaches the court to seek redressal but in the present case, in view of Section 13(1) of the Act the creditor is empowered to enforce the security himself without intervention of the Court. Therefore, it goes with logic and reason that he may be checked to communicate the reason for not accepting the objections if raised and before he takes the measures like taking over possession of the secured assets etc.

In the case of *Krushna Chandra Sahoo v. Bank of India and others*, It was held that "it is obligatory on the part of the authority first to consider and dispose of the objection by a speaking and reasoned order and communicate the order to the person aggrieved i.e., the borrower/guarantor. It is a condition precedent for issuance of notice under Section 13(4) of

[11] *Supra Note* 1.

the Act. The authority cannot ignore the statutory provisions treating them merely to be a decoration piece in the statutes rather they require strict adherence for the simple reason that the financial institutions have been conferred with certain privileges for making expeditious recovery from the borrowers by-passing the onerous and lengthy procedure of civil suits."[12]

In the case *Sunanda Kumari Wife Of L.R. ... vs Standard Chartered Bank*, It was held that , "Section 13 (3A) casts a duty on the secured creditor to consider the representation made or objection raised by the borrower and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he is bound to communicate to the borrower the reasons for non-acceptance within one week of receipt of the representation or objection. Thus, Sub-section (3A) confers on the borrower a right to know the reasons for the non-acceptance of his representation or objection by the secured creditor. Hence the secured creditor is statutorily bound to consider the borrower's representation or objection and if the representation or objection is not tenable or acceptable, he is also bound to communicate the reasons for such non-acceptance. If the borrower does not receive any communication from the secured creditor conveying the reasons for non-acceptance of the objection, he is entitled to presume that the secured creditor has found the representation acceptable and the objection tenable. Since the respondent-bank failed to discharge its statutory obligations under Sub-section (3A) of Section 13 of the Act, the action initiated by the respondent under Sub-section (4) of Section 13 and Section 14 is illegal and irregular."[13]

In the case of *Tensile Steel Ltd., and another v. Punjab and Sind Bank and Others*, It was held that "Sub-section (3-A) of Section 13 of the Act of 2002 enjoins the Bank to consider and decide such reply/objection and to communicate the decision thereof., Unless and until the said exercise is completed, the Bank is not authorised to proceed further and take any of the measures under Sub-section (4) of the said Section 13. In the present case, it is indisputable that the Bank, without complying the mandatory requirement under Sub-section (3-A) of the said Section 13, proceeded further under Sub-section (4) of the said Section 13, took the assistance of the District Magistrate under Section 14 of the Act of 2002; and took

[12] *AIR 2009 Orissa 35*.
[13] 2007 135 CompCas 604 Kar.



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over the possession of the secured assets. The action of the Bank is certainly contrary to the statutory mandate. The same requires being quashed and set aside on that ground alone.[14]

**Rights during taking of Measures by the bank/ Financial institutions**

It was held in the case of *M/S Transcore v Union of India* that " Section 13(2) is not merely a show cause notice, it is a notice of demand. That notice of demand is based on the footing that the debtor is under a liability and that his account in respect of such liability has become sub-standard, doubtful or loss. The identification of debt and the classification of the account as NPA is done in accordance with the guidelines issued by RBI. Such notice of demand, therefore, constitutes an action taken under the provisions of NPA Act and such notice of demand cannot be compared to a show cause notice. In fact, because it is a notice of demand which constitutes an action, Section 13(3-A) provides an opportunity to the borrower to make representation to the secured creditor. Section 13(2) is a condition precedent to the invocation of Section 13(4) of NPA Act by the bank/FI. Once the two conditions under Section 13(2) are fulfilled, the next step which the bank or FI is entitled to take is either to take possession of the secured assets of the borrower or to take other measures." [15]

**Right to prefer an appeal**

The next safeguard available to a secured borrower within the framework of the Act is to approach the Debt Recovery Tribunal under Section 17 of the Act. Such a right accrues only after measures are taken under sub-section (1) of Section 13 of the Act.

Most recently in KanaiyalalLalchand Sachdev v. State of Maharashtra, the Supreme Court observed that "Section 13(3-A) of the Act was inserted by Act 30 of 2004 after the decision of this Court in Mardia Chemicals and provides a last opportunity for the borrower to make a representation to the secured creditor against the classification of his account as a non-performing asset. The secured creditor is required to consider the representation of the borrowers, and if the secured creditor comes to the conclusion that the representation is not

[14] 2007 139 CompCas 359 Guj.
[15] *Supra Note* 2.



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tenable or acceptable, then he must communicate, within one week of the receipt of the communication by the borrower, the reasons for rejecting the same."

Supreme Court in *M/S Transcore* case held that "issuance of notice under Section 13(2), consideration of objections and intimating the decision on such objections to the borrower under Section 13(3-A) and taking possession under Section 13(4) all constitute action taken by the Banks and Financial Institutions for the purpose of the SARFAESI Act."[16]
It was further held that "Section 17 provides that any person [including a borrower] aggrieved by any of the measures referred to in sub-section (4) of Section 13, taken by the secured creditor can approach the Debts Recovery Tribunal within forty-five days from the date on which such measures had been taken. Section 17(2) mandates that the Recovery Officer should consider as to whether any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor for enforcement of the security are in accordance with the provisions of the Act and the rules made thereunder."[17]

## Conclusion

Within the limited scope of expanding principle of natural justice, fairness, and equity, the courts have developed required jurisprudence of rights of the debtor under SARFESI Act, 2002. The right to get a proper hearing and reasoned the decision on objections files have been developed as important procedures before taking measures under Sec 13(4) of the Act. From right to make as many representations as a borrower can to right to get reasoned order while rejecting those objections have been emphasised by the courts. If any of the objections raised by banks and Financial Institutions have not been dealt properly or principal of natural justice is not followed then these points can be raised before DRT in appeal and before the high court and the supreme court in writ petitions.

[16] *Supra Note 1.*
[17] *Ibid.*



**ISSN 2454-1273**