

Financial Service Update

July 28, 2014

SC: STATUTORY NOTICE OF SALE OF SECURED ASSET MANDATORY UNDER SARFAESI

- Supreme Court emphasizes substantive rights of debtor to property and reinforces procedural due process for effecting sale of secured properties;
- Supreme Court holds that right to property is a constitutional and any action by a secured creditor can only be in strict compliance with the law. Consequently, no sale of secured asset can be made under SARFAESI Rules without complying with statutory period of notice of sale to the debtor;
- Judgment does not provide any safeguards or deterrents to dilatory tactics of debtors.

INTRODUCTION

In *Mathew Varghese vs. M. Amritha Kumar*¹ ('**Ruling**'), the Supreme Court of India ('**Supreme Court**') held that notice to borrower under Rule 8 and 9 of the Security Interest (Enforcement) Rules, 2002 ('**Rules**') are mandatory requirements to conduct a valid sale of secured immovable property by a secured creditor under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (**SARFAESI Act**). On an analysis of Section 29² of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 ('**RDDBI**') and Section 37³ of the SARFAESI Act, the Supreme Court held that the conditions in Rule 8 of the Rules have to be strictly followed in the sale of secured assets. Consequently, if 30 days' notice as mandated under Rule 9⁴ of the Rules is not provided to the borrower a valid sale cannot be effected and the secured creditor cannot rely upon an earlier notification of sale as such notification would be considered to have lapsed.

BACKGROUND

Jerry Merry Exports Pvt. Ltd.' ('**Borrower**') acquired a credit facility from the respondent No. 4 before the Supreme Court ('**Bank**') while the first and second respondents stood as guarantors ('**Guarantors**') in respect of the debt. Guarantors created an equitable mortgage on certain properties ('**Properties**') by deposit of title deeds. When the debt became a non-performing asset ('**NPA**') the Bank filed an Original Application before the Debt Recovery Tribunal, Ernakulam ('**DRT**') for recovery of dues to the tune of Rs. 33,77,053/- along with interest @ 18% per annum. The Bank also filed an application under Section 13(2)⁵ of the SARFAESI Act on 11.08.2006 for a sum of Rs. 70,77,590/-. On 20.02.2007 the Bank sought to take possession of the Properties under Section 13(4)⁶ of the SARFAESI Act read with Rules 8 and 9 of the Rules. The Guarantors subsequently filed an application under Section 17⁷ of the SARFAESI Act ('**Application**') before the DRT challenging the action under Section 13(4) taken by the Bank. An attempt was made for a One Time Settlement ('**OTS**') of Rs. 55,00,000/- but the attempts failed and Bank also withdrew the offer.

Subsequently on 23.08.2007 the Bank published a notice for sale of Properties as mandated under Rule 9 of the Rules ('**Notice of Sale**'). The appellant before the Supreme Court ('**Appellant**') submitted its tender on 30.08.2007. On 20.09.2007 the Guarantors filed a writ petition before the Single Judge in Kerala High Court challenging the actions of the Bank under SARFAESI Act. The Kerala High Court disposed off the writ petition by its Order dated 20.09.2007 ('**Single Judge's Order**') directing the DRT to dispose the Application expeditiously and that the proposed sale scheduled on 25.09.2007 be deferred by six weeks by imposing a condition on the Guarantors to deposit Rs. 10,00,000/- before 25.09.2007. The Bank was directed to accept the OTS amount of Rs. 55,00,000/- if the Guarantor made the payment within a reasonable time. Pursuant to Single Judge's Order, the sale was postponed and Guarantors deposited Rs. 10,00,000/- with Bank. On 27.12.2007 DRT dismissed the Application with cost and the following day the Bank accepted the offer of Appellant for Rs. 1,27,00,101/- The sale was subsequently confirmed by the Bank and the Guarantors were directed to collect balance consideration from the Bank.

Guarantors filed a review petition against Single Judge's Order which was dismissed and an appeal against this order was also dismissed. Guarantors challenged the sale in a fresh writ petition. The Single Judge dismissed the writ petition and in appeal, the Division Bench passed a detailed order dated 08.03.2010 allowing the appeal ('**Division Bench Order**'). The Ruling was passed by the Supreme Court in an appeal against the Division Bench Order.

The Division Bench Order provided that the sale was not conducted in a fair manner, as procedures under the SARFAESI Act and Rules were not followed. It observed that when the sale was initially postponed by six weeks from 25.09.2007, the Bank ought to have renotified the sale as mandated under Rule 9 of the Rules or at least extended the time to receive further tenders especially in light of the fact that only one valid tender was received. The Division Bench also set aside the sale in favour of Appellant and directed Guarantors to furnish a demand draft of Rs. 2,00,00,000/- within a stipulated period. Subsequent to the Division Bench Order, the Guarantors did not comply with the directions but instead filed applications seeking extension of time and in pursuance of the same, respondent No.

Research Papers

Handbook on New Labour Codes

April 29, 2024

Compendium of Research Papers

April 11, 2024

Third-Party Funding for Dispute Resolution in India

April 02, 2024

Research Articles

Private Client Insights - Sustainable Success: How Family Constitutions can Shape Corporate Governance, Business Succession and Familial Legacy

January 25, 2024

Private Equity and M&A in India: What to Expect in 2024?

January 23, 2024

Emerging Legal Issues with use of Generative AI

October 27, 2023

Audio

Third-Party Funding: India & the World

April 27, 2024

IBC allows automatic release of ED attachments: Bombay HC reaffirms

April 15, 2024

The Midnight Clause

February 29, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Q&A 2024 Protocol to the Mauritius India Tax Treaty

April 22, 2024

Boost to India's Space Potential: India Liberalizes Foreign Direct

8 before the Supreme Court ('Subsequent Buyer') was awarded the sale. The Division Bench Order and grant of extension were challenged by the Appellant in Supreme Court.

ISSUE IN SUPREME COURT

The Supreme Court had to consider the procedure for sale of property secured by a creditor as set out in Section 13 (8)⁸ of SARFAESI Act and Rules 8 and 9 of Rules.

CONTENTIONS OF THE APPELLANT

- Single Judge’s Order incorporated the principles of Rules 8 and 9. The sale was deferred by six weeks and sufficient notice was given to the Guarantors. In effect Guarantors had sufficient notice of sale (approximately 90 days) but failed to make the payment of the OTS amount within such period.
- The Single Judge took into account the entitlements of Guarantors who stepped into the shoes of the borrowers as provided under Section 13(8) of the SARFAESI Act. Therefore, a sale effected after the expiry of the period of six weeks granted by the Single Judge and after the dismissal of the Application of the Guarantors by the DRT, cannot be held to be violative of Section 13(8) of the SARFAESI Act.
- Court should not interfere with a sale which has been effected and confirmed in accordance with law if subsequently a higher offer appears relying on *Valji Khimji and Co. V. Official Liquidator*⁹ and *United Bank of India v. Satyawati Tondon*¹⁰.
- An alternative efficacious remedy was available to Guarantors under the SARFAESI Act and High Court should not have exercised its jurisdiction under Article 226 of the Constitution of India. Hence the writ petition challenging the sale was itself not maintainable.

CONTENTIONS OF THE SUBSEQUENT BUYER

- Section 13(8) of the SARFAESI Act is similar to Section 60¹¹ of the Transfer of Property Act, 1882 ('TP Act'). The Notice of Sale did not survive after passing of the order of the DRT on 27.12.2007.
- Relying upon Section 29 of the RDDB Act, Section 37 of the SARFAESI and Rule 15 of the Second Schedule of the Income Tax Act, 1961 it was contended that even under the provisions of the SARFAESI Act there was a statutory requirement for re-notification to effect the sale and non – compliance of the same would render the sale invalid.
- Intimation to Guarantors after sale of Properties to Appellant by Bank to collect the surplus amount was not sufficient intimation or notice as mandated under the SARFAESI Act.
- The mortgagor’s right to redemption is statutorily recognised and continues till the time of registration of sale, this principle is also incorporated in Section 13(8) of the SARFAESI Act read with Rules 8 and 9 of the Rules. Consequently, the debtor would always have a right of redemption even if the debt was an NPA and the creditor’s right of sale would be subject to debtor’s right of redemption.

CONTENTIONS OF THE GUARANTORS

- Section 13(1)¹² of the SARFAESI Act clearly provides that Sections 69¹³ and 69A¹⁴ of the TP Act dealing with sale of mortgaged property without the intervention of the court are inapplicable to a sale conducted under the SARFAESI Act. But these provisions did not restrict the implication of Section 60 of the TP Act which deals with right of redemption of the mortgagor.

SUPREME COURT DECISION

The Supreme Court acknowledged the constitutional right to hold property and that this right could not be deprived in a manner which was contrary to the procedure established by law (Article 300A of the Constitution of India). The Supreme Court further observed that a secured creditor was like a trustee of the secured asset and could not deal with the security in a ‘whimsical’ or ‘arbitrary’ manner. Section 13 (8) of SARFAESI Act was provided to protect interest of borrowers and it was important to balance the right of borrowers and creditors. The Supreme Court further observed that Rule 8 and Rule 9 of the Rules had twin objectives:

- Provide 30 days clear notice to the borrower regarding the date and time of the proposed sale or transfer. This is to provide the borrower adequate opportunity to take all steps to repay his dues prior to such sale.
- Inform the intending purchaser of the nature of the property, extent of liability, floor price and other encumbrances.

In light of this reasoning, the Supreme Court held that unless 30 days’ clear notice was given to the borrower, sale or transfer could not be effected by a secured creditor under the SARFAESI Act. If a sale is notified after due notice but sale does not take place, the secured creditor cannot effect the sale or transfer of the secured asset on any subsequent date relying upon earlier notification. It is also important to keep in mind the provisions of sub-rule (8) of Rule 8 according to which sale by any method other than public action or public tender may be on terms that are settled between the parties in writing.

While the Supreme Court upheld the interpretation given to SARFAESI Act and Rules given by the High Court, it set aside the cancellation of the sale made in favor of Appellant and held that the safeguards that were applicable to a property owner, were equally applicable to the auction purchaser. The Supreme Court held that Guarantors had failed to take measures as per the Division Bench Order and consequently, the sale in favor of Appellant had to be confirmed. However, in view of the passage of time (sale had been confirmed in 2010), Supreme Court directed that Appellant pay an additional amount of approximately Rs. 70 Lakhs towards sale price.

The Supreme Court has reiterated the abovementioned position in two subsequent judgements *J.Rajiv Subramaniam and Anr. V. Pandiyas* and Ors¹⁵ and *Vasu P. Shetty v. Hotel Vandana Palace and Ors.*¹⁶ Interestingly, in *Vasu P. Shetty* the Supreme Court went a step further and emphasised that compliance with 30 days’ notice ought to be observed even in a case when the borrower resorts to dilatory tactics.

OUR ANALYSIS

Laudably, the Ruling has attempted to preserve the right to property of the borrower by ensuring that a borrower is not disposed without due process of law, the underlying premise being that secured creditors are not allowed to abuse the wide powers provided to them under the SARFAESI Act. However, this Ruling has certainly swung the pendulum unduly in favor of the borrowers. The SARFAESI Act was enacted with a distinct purpose to facilitate banks

and financial institutions to recover dues in a speedy manner by enforcement of security interest without intervention of the court. The object of the debt recovery laws is to reduce non-performing assets and increase liquidity in the market. Unscrupulous borrowers can take advantage of observations in the *Vasu Shetty* case and the Ruling to frustrate monetization of securities. For instance, on each occasion when an action for sale is undertaken by the secured creditor, the borrower can make an offer for OTS. If the bank or financial institution agrees, the borrower can legitimately buy time and avoid payment. Consequently, the bank or financial institution would have to issue a fresh notice under Rule 9 of the Rules for each default. Multiple notices and protracted litigation will undoubtedly drive away auction purchasers, dissuade investment in distressed assets and effectively defeat the very object of the SARFAESI Act. The onus is clearly on auction purchasers and secured creditors to ensure that they are vigilant on enforcement process and diligent on realization. Till date all efforts for expeditious recovery of dues to banks and financial institutions through various legislations have been ineffective. It is high time a balance is achieved between protection of a borrower's rights and recovery of public money, individual rights cannot be allowed to override larger public interest. In the present context this would not only be justice but economic prudence.

– **M.S. Ananth & Pratibha Jain**

You can direct your queries or comments to the authors

¹ (2014)5 SCC 610

² S. 29 RDBB: The provisions of the Second and Third Schedules to the Income-tax Act, 1961 (43 of 1961), and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time shall, as far as possible, apply with necessary modifications as if the said provisions and the rules referred to the amount of debt due under this Act instead of to the income-tax: Provided that any reference under the said provisions and the rules to the assessee" shall be construed as a reference to the defendant under this Act.

³ S. 37. Application of other laws not barred: The provisions of this Act or the rules made there under shall be in addition to, and not in derogation of, the Companies Act, 1956 (1 of 1956), the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) or any other law for the time being in force

⁴ Rule 9(1) of the Rules: No sale of immovable property under these rules shall take place before expiry of thirty days from the date on which the public notice of sale is published in newspapers as referred to in the proviso to sub-rule (6) or notice of sale has been served to the borrower.

⁵ S.13(2) 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 sub-section (4).

⁶ S. 13(4) 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 the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

⁷ S.17 (1) Right to appeal.- Any person (including borrower), aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this Chapter, may prefer an appeal to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken

⁸ S. 13(8) If dues of the secured creditor together with all costs, charges and expenses incurred by him are tendered to the secured creditor at any time before the date fixed for sale or transfer, the secured asset shall not be sold or transferred by the secured creditor, and no further step shall be taken by him transfer or sale of that secured asset.

⁹ (2008) 9 SCC 299

¹⁰ (2010) 8 SCC 110

¹¹ S. 60. Right of mortgagor to redeem :At any time after the principal money has become due, the mortgagor has a right, on payment or tender, at a proper time and place, of the mortgage-money, to require the mortgagee (a) to deliver to the mortgagor the mortgage-deed and all documents relating to the mortgaged property which are in the possession or power of the mortgagee, (b) where the mortgagee is in possession of the mortgaged property, to deliver possession thereof to the mortgagor, and (c) at the cost of the mortgagor either to re-transfer the mortgaged property to him or to such third person as he may direct, or to execute and (where the mortgage has been effected by a registered instrument) to have registered an acknowledgement in writing that any right in derogation of his interest transferred to the mortgagee has been extinguished: PROVIDED that the right conferred by this section has not been extinguished by the act of the parties or by decree of a court.

¹² S. 13(1): Enforcement of security interest – Notwithstanding anything contained in Section 69 or Section 69A of the TP Act any security interest created in favour of any secured creditor may be enforced, without the invention of the court or tribunal, by such creditor in accordance with the provisions of this Act

¹³ S. 69 Power of sale when valid

(1) A mortgagee, or any person acting on his behalf, shall, subject to the provisions of this section have power to sell or concur in selling the mortgaged property or any part thereof, in default of payment of the mortgage-money, without the intervention of the court, in the following cases and in no others, namely,-

....

....

(2) No such power shall be exercised unless and until-

(a) notice in writing requiring payment of the principal money has been served on the mortgagor, or on one of several mortgagors, and default has been made in payment of the principal money, or of part thereof, for three months after such service;

.....

¹⁴ S. 69A. Appointment of receiver

(1) A mortgagee having the right to exercise a power of sale under section 69 shall, subject to the provisions of sub-section (2), be entitled to appoint, by writing signed by him or on his behalf, a receiver of the income of the mortgaged property or any part thereof.

....

¹⁵ (2014) 5 SCC 651

¹⁶ (2014) 5 SCC 660

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.