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BANKING LAW

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I INTRODUCTION

THE YEAR 2013 was an important year for banking companies and financial institutions. While there was an increase in the non-performing assets (NPA) problem bedevilling the Indian financial sector, the Companies Act, 2013 has many implications for it, especially in terms of security registration and financial reconstruction.

This survey however, is limited to important judicial pronouncements on statutes relating to the sector or having a bearing on it as well as customary banking law. So not only does it cover pronouncements on Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), Recovery of Debt due to Banks and Financial Institutions Act, 1993 (RDDB&FI Act) but also Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), State Finance Corporations Act, 1951 (SFCA), Banking Regulation Act, Reserve Bank of India Act(RBI Act), as well as state statutes for protection of depositors.

II JUDICIAL PRONOUNCEMENTS UNDER SPECIAL LAWS

Sick Industrial Companies (Special Provisions) Act, 1985

In *Apollo International Ltd.* v. *Supriya Pharmaceutical Ltd.*,[1] the Delhi High Court was called upon to look into the extent of the bar on proceedings against a Sick Industrial Company under section 22 Sick Industrial Companies (Special Provisions) Act, 1985 (SICA). The court considered the judgement of Supreme Court in *Raheja Universal Ltd*. v. *NRC Ltd*.[2] The Supreme Court was of the opinion that though it was difficult to say with certainty what was the extent of moratorium under section 22 without the leave of Board for Industrial and Financial Reconstruction (BIFR)**,** but it would apply to assets of company, which may be subject to scheme framed by BIFR. The Delhi High Court took this as implying that bar under section 22 of SICA should be limited to proceedings, which were in the nature of execution, distress sale and like which would deny the sick company of

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1 I (2013) BC 56.

2 AIR 2012 SC 1440.

its assets. Therefore, in its view there was no barrier under section 22 of SICA to instituting a simple money suit.

Since 2002, a question has come forward that if three fourth of the creditors by value agree as per section 13(4) of SARFAESI Act, then at what stage should proceedings automatically abate as per proviso to section 15(1) of SICA. While the Orissa High Court was of the view in *Noble Aqua Pvt. Ltd*. v. *State Bank of India*[3] was at one extreme that once an industry had been declared 'Sick' the proviso to section 15 (1) of SARFAESI could not be invoked, others, namely Madras, Kerala, Delhi, Bombay, Gujarat and Punjab and Haryana High Courts were of the view that proceedings would abate irrespective of the state at which reference had reached. But the question was what the term reference would include as proceedings would start with reference under section 15 and thereafter includes inquiry (section 16), declaration of sickness (section 17), appointment of operating agency (section 17), sanction of scheme (section 18), rehabilitation (section 19), winding up (section 20) and appeal (section 25). The different high courts had their differences when reference could be said to end. Though Division Bench of Madras High Court had in *Triveni Alloys Ltd*. v. *Board for Industrial and Financial Reconstructions* [4] already said that abatement of reference was with regard to any stage of reference proceedings, including the appellate stage, another division bench of the high court expressed its doubts as to soundness or the judgement and Full Bench of the Madras High Court looked into the matter afresh. The judgement of the Full Bench looked into the history of legislation relating to Companies (Second Amendment) Act, 2002, SARFAESI Act, SICA Repeal Act, 2003 and SARFAESI Amendment Act, 2004. It pointed out that while section 41 or SARFAESI Act amended provisions of Companies Act, Securities Contract (Registration) Act (SCRA) and SICA, section 37, which saved the operation of a few named statutes by stating that it shall be in addition to and not in derogation to them only mentioned Companies Act,1956 and SCRA. The explicit absence of SICA, while the other two were mentioned meant that SICA could not be brought under the pale of 'any other law for the time being in force'. Further Companies (Second Amendment) Act and SARFAESI Amendment Act, National Company Law Tribunal was provided for as a substitute for BIFR and a procedure akin to SICA were introduced in Part –VI-A (section 424 A-424 H) or the Companies Act,1956. The high court was of view that if all proceedings before the tribunal could end, which would in status be higher than BIFR and AAFIR, if three fourth of creditors so decided, then the intention of legislature certainly could not have been to clothe the BIFR with powers greater than that of the tribunal looking into the scheme of the SICA. There was nothing amiss as the BIFR was not a normal court but more akin to the court conducting proceedings under section 392 of Companies Act, 1956 and would end the proceedings only after the company is wound up or revived, with the latter dependent upon the cooperation of borrower and creditors. So 'reference' could not refer just the stage of receipt of intimation

3 AIR 2008 Ori 103.

4 (2006) 132 Comp Cases 190 (Mad).

of sickness but has to flow to the end / all stages, and would include all acts of board including AAIFR from section 15 of SICA to section 20 of the Act.

State Financial Corporations Act, 1951

Debtors when faced with taking over of charged property by creditor adopt various delaying tactics to prevent the creditor from enforcing its security. *Asiatic Holiday Resorts Pvt. Ltd.*v. *EDC Ltd, Maharashtra State Financial Corporation and Land view Construction Pvt. Ltd*.[5] relates to whether the State Finance Corporations, governed by State Finance Corporations Act, 1951 (SFCA) were under any obligation to give the defaulting debtor an opportunity to match the bid made by another when the secured property is auctioned. The Bombay High Court referred to the Supreme Court decision in *Haryana Financial Corporation* v. *Jagdamba Oil Mills* [6] and its observation that fairness was not a one way street. Also one had to look into all the circumstances of the case and see whether the debtor was only seeking to delay. A State Financial Corporation, though could not act unreasonably, it is under no obligation to give a reasonable time to a consistent defaulter an opportunity to match the highest offer.

In *Karnataka State Industrial Investment Development Corp. Ltd.* v. *Commissioner of Income Tax and Tax Recovery Office, Mangalore* [7] the issue before Karnataka High Court was as to who had priority over the assets of a defaulting company, the revenue or the State Finance Corporation which had security over the said assets. The State Finance Corporation took possession of the mortgaged property under section 29 of the SFC Act but could not sell it as it was not getting the no-objection certificate from the income tax department on the ground that the assessable tax dues were prior in time and therefore it had priority. The court reviewed various decisions of the Supreme Court where revenue claimed first charge over an asset in priority over a charge holder *e.g. Union of India* v. *Sicom Ltd.*,[8] *Union Bank of India* v. *Somasunderam Mills (P) Ltd.*,[9]*Central Bank of India* v. *State of Kerala.*[10]It found that a common thread in all the cases was whether the statute by which revenue was due created a first charge in favour of revenue. If not, the charge holder prevails. In the case before it, it found that IT Act nowhere created first charge on the property of assessee for its tax dues, though provisional attachment orders could be issued under section 281 B of IT Act,1961. Hence the dues of the IT department are postponed to that of charge holder, especially SFC.

In *Smt. Kamala Krishna Murthy* v. *Karnataka State Financial Corporation,*[11] the Karnataka High Court was called upon to look into the impact of section 34 of

5 IV (2013) BC 613.

6 (2002) 3 SCC 496

7 AIR 2013 Kant 104.

8 (2009) 2 SCC 121.

9 (1985) 2 SCC 40.

10 (2009) 4 SCC 994.

11 III (2013) BC 421 (Kar).

SARFAESI Act upon section 31 (1) (aa) of SFC Act. While section 34 of SARFAESI bars the jurisdiction of civil court in respect of a matter which is before the DRT or Appellate Tribunal, Section 31(1) (aa) of the SFC Act allows the State Finance Corporation to approach the district judge for relief, one of which included enforcing the liability of any surety. The high court opined that there was no barrier under SARFAESI in proceeding against a guarantor under SFC Act, if his security was not being sought to be enforced under SARFAESI Act.

In *Gujarat State Financial Corporation* v. *Yasika Cycles Pvt. Ltd.,* [12]the Gujarat High Court had the occasion to interpret the scope of section 31 of SFC *vis-a-vis* the principle that it is the court within whose jurisdiction the property is situated which will have jurisdiction for ex execution proceedings section 31 of SFC Act gives the jurisdiction to the court where the unit was situated which took the loan. The court, taking account of Supreme Court judgement in *Karnataka State Industrial Investment Corporation Ltd.* v. *S.K.K. Kulkarni*[13] and its observation on section 46 B of SFC Act (a non-obstante clause), held that location of property was immaterial. What was relevant was the location of unit.

In *AGM, Karnataka State Financial Corporation* v. *General Section, Mysore Division Ind work,*[14] the Supreme Court read the limitation in section 46 B of SFC Act in the rights exercised of it as a secured creditor under section 29 of it. Section 46 B of SFC Act, while it starts as a non-obstante clause, later specifies that it was in addition to and not in derogation of any other law in force. In the normal course, when a company has come into liquidation, the claim of workmen has a preference and rank *paripassu* with secured creditors. Though the company's winding up order had not been given, the high court, on account of company having closed down its manufacturing operations, had equated the adjudicated claims of workers on the same footing. The Supreme Court while agreeing with it did not enunciate why they were comparative other than emphasizing the importance of section 46 B of SFC Act, which unfortunately does not throw much light.

Recovery of Debts due to Banks and Financial Institutions Act, 1993 (DRT Act)

Assignment of debt

Kotak Mahindra Bank Ltd. v. *The Official Liquidator Hukumchand Mills Ltd.*,[15] is an interesting case on assignment of debt *i.e.*, whether the recovery officer could bring on record an assignee of debt in place of judgement creditor. Section 29 of the DRT Act refers to the second and third schedules of the IT Act with necessary modifications as if the said provisions referred to debt instead of income tax and reference to 'assesse' shall be construed as reference to defendant. The relevant rule in IT Act was Rule 85 wherein in case of death of defaulter proceedings were to be continued against the legal representative of the defaulter

12 III (2013) BC 77.

13 (2009) 2 SCC 236).

14 (2013) 10 SCC 638.

15 AIR 2013 Born 83.

as if the legal representative were the defaulter. In the Court's opinion, both the recovery officer and presiding officer could bring the assignee on record.

In *Sachdeva and Sons Rice Mills Ltd.* v. *Kotak Mahindra Bank Ltd. and Drs.*[16]the Punjab and Haryana High Court was presented with the plea by petitioners that assignment of debt was securitization and it could only be done to a securitization company registered with the RBI under SARFAESI Act. The court pointed out to petitioners that they had neither considered section 130 of Transfer of Property Act, 1882 nor the decision of apex court in *ICICI Bank* v. *Official Liquidator of APS Star Industries Ltd.*,[17] which was precisely on the given set of circumstances.

Jurisdiction of DRT in recovery proceedings

Bombay Tushar P. Shah v. *International Asset Reconstruction Co. P. Ltd.*,[18] had to delve into whether the principle laid down in section 39(4) of Code of Civil Procedure would be applicable to proceedings, by Debt Recovery Tribunals (DRT) by analogy. Section 39(4) of CPC implicitly provides that if the property subject to decree is situated in the jurisdiction of another court, then that Court has the exclusive jurisdiction in case of execution proceedings relating to the said property, by declaring that a court which passed a decree cannot execute it against a person or property outside its jurisdiction. This meant that the word 'may' in section 39(1) of CPC was to be read as shall. No such corresponding provision was there in RDDB & FI Act. Hence, the Bombay High Court concurred with the view of Gujarat High Court in *Bank of Baroda* v. *Balbir Kumar Paul*[19] that there was no need to read 'may' in Section 19(23) of RDDB&FI Act as 'shall' as was done in case of section 39(1) of CPC. Hence, the DRAT of Mumbai had jurisdiction to proceed against immoveable property situated in Vapi, within the jurisdiction of DRT, Ahmedabad.

Appeal against interlocutory order of DRT

In *Satapa Chatterjee* v. *UCO Bank*[20]Calcutta High Court had the occasion to look into the scope of section 21 of RDDB&FI Act, which provides that to prefer an appeal, the appellant from whom debt is due had to deposit seventy five percent of the debt so due for the appeal to be entertained by the appellate tribunal. The court read 'debt is due' to mean debt which had been adjudged to be due. Therefore, an appeal against an interlocutory order (denial of opportunity to cross examine a witness in this case) when no debt had still been adjudged to be due would not require deposit of the debt claimed by the bank. The court ignored sub rule (2) of Rule 8 of Debts Recovery Appellate Tribunal (Procedure) Rules, 1994 which quantified the fee payable in appeal in terms of 'amount of debt due'. The more appropriate term, in its view is amount of debt 'claimed to be due or amount of debt

16 IV (2013) BC 570.

17 (2010) 10 SCC 1.

18 [V (2013) BC 502).

19 AIR 2010 Guj124.

20 IV (2013) BC 252.

due' as the subordinate legislation cannot be in excess of or in derogation of the statute under which it is made.

Procedure of DRT for indigent person

In *Saroj Devi* v. *Bank of India*,[21] Delhi High Court had the occasion to look into the extent or applicability of the principles of CPC in the procedure followed by the DRT. The petitioner had preferred an appeal to DRAT against orders of DRT in which she was allowed to pursue as an indigent and no court fee was payable. The case was remitted to the DRT for disposal on merits. In the DRT, the petitioner sought leave to file counter claim and also made an application for being declared indigent, a request the DRT rejected on grounds that there was no provision in the Act for this, and that the DRT was not bound by the procedure laid down by CPC. According to the high court, while section 22 of RDDB&FI Act did specifically provide that the tribunals under the Act were not bound by the procedure laid down by CPC, but they were still to be guided by principles of natural justice and therefore the procedure should not be such as to result in denial of justice. A right which otherwise existed (preferring a counter claim and on account of indigence seek relief in court fee payable) is not lost because an Act has come to speed up claims. Holding so would be discriminatory.

Discretion of recovery officer

An important question which arises is what the discretion of the recovery officer is. As per section 29 of RDDB & FI Act. Section 29 provides that second and third schedules of IT Act shall, as far as possible, apply with necessary modifications as if ' they referred to the debt due under the Act'. In *C.N. Paramsivam* v. *Sunrise Plaza Tr. Partner,*[22] the Supreme Court was confronted with the question whether the words 'as far as possible' gave any discretion to the recovery officer and if so to what extent. In the Court's view, while the words did connote an inbuilt flexibility, 'the scope of that flexibility extends only to what is' not at all practicable", which would be because they relate to recovery of income tax and cannot have any role in a recovery proceeding under RDDB & FI Act. The concerned rules, Rule 57 and 58 of Second Schedule to IT Act, which related to deposit of minimum amount by auction purchaser within a certain period, could only be regarded as mandatory and were not susceptible to being tweaked by recovery officer. The rules also reflected a procedural consistency followed by the legal system as regards auctions sales in so far as they had followed the scheme in Rule 84-86 of Order XXI of CPC.

In a similar vein, the Madras High Court in *N. Sadasivam* v. *Indian Bank*[23] re-emphasised the mandatory nature of requirement of proclamation before sale of property in auction as this has a bearing on price received.

The recovery officer's role is equivalent to that of an executing court. He does not have any supervisory or appellate role over the Presiding Officer of the

21 IV (2013) BC 659.

22 (2013) 9 SCC 460.

23 IV (2013) BC 640.

DRT. This was emphasised by the Madras High Court in *HDFC Bank* v. *Recovery Officer, DRT.*[24]In the case, the recovery officer forfeited the amount deposited by the auction purchaser, to the government on the ground that the withdrawal of application by the bank, allowed by DRT as well as issuance of recovery certificate by it was fraudulent and an act of collusion. The high court had to point to the limited role envisioned for recovery officer.

Jurisdiction of DRT *vis-a-vis* civil court

In M/*S Super Sales Corporation and Ramothar Kedia* v. *Debt Recovery Tribunal*[25] an interesting issue arose before the Karnataka High Court as to the extent of DRT's jurisdiction in relation to contractual relations of the judgement debtor with third parties. A school had entered into a MOU with the judgement debtor to buy the secured property which was to be sold towards satisfaction of the debt due to the bank. The tribunal decreed that the trust deposit the due debt with the bank and the remaining amount of sale consideration which would be paid to DRT for the benefit of the judgment debtors. The judgement debtors (who were the petitioners) claimed that by this DRT was usurping jurisdiction in deciding upon a case which related to specific performance of contract of a third party with the judgement debtor. The high court pointed out the fallacy of such an argument. In its view, if the DRT could give garnishee orders, then *ipso facto* it must also have the jurisdiction to decide whether any debt was due from such third party to the judgement debtor otherwise we would be having an incongruous result of DRT defending its order in a civil court. The court took cognisance of the fact that the Trust had already paid part of consideration to the bank towards part satisfaction of the debt of petitioners, which the bank had appropriated and it was also already in possession of the immovable property. In the view of the court, there was no need to read a limitation in DRT's power under section 19(25) of RDDB&FI Act which provides that the tribunal could make such orders and give such directions as may be necessary or expedient to give effect to its orders or to prevent abuse of its process or secure ends of justice.'

Jurisdiction of DRT *vis-à-vis* company court

In the *Official Liquidator, U.P and Uttarakhand* v. *Allahabad Bank* [26]the issue before the Supreme Court was the role of the company court and official liquidator where the company being subject to winding up proceedings was also subject or recovery proceedings under the RDDB & FI Act. The court reiterated the principles laid down in *Allahabad bank* v. *Canara Bank*[27]and *Rajasthan State Financial Corporation* v. *Official Liquidator*[28]and distinguished them from the judgement in *M.V Janardhan Reddy* v. *Vijaya Bank* [29]According to it, the

24 I (2013) BC 202.

25 III (2013) BC175.

26 AIR 2013 SC 1823.

27 (2000) 4 SCC 406.

28 (2008) 7 SCC 738.

29 (2005) 8 SCC 190.

jurisdiction of high court as a company court was ordinary and not extraordinary or inherent. Being an original jurisdiction, conferred by statute, they can be subject to another statute. The RDDB & FI Act was a special and later statute, which was comprehensive in nature and had a non-obstante clause. Therefore the company court did not have jurisdiction in matters before the DRT. The official liquidator did have a role that is of overseeing that the interests of workers and others, including secured and unsecured creditors are protected. But that role has to perform within the four corners of the RDDB & FI Act. So, if he was dissatisfied with the process of sale *etc*. followed by the recovery officer, then he ought to approach the DRT in appeal and not the company court which had no jurisdiction on the matter. The distribution of the recovered money as per section 19(19) of RDDB&FI Act, was to be made in accordance with section 529A of the Companies Act, 1956. One point of interest is that the court reasoned that the primacy of RDDB & FI Act over Companies Act,1956 was because that it was special statute and later in point of time as against SFC Act which was prior in time. The implications of it in having a new Companies Act, 1956 in determining which should have primacy would be interesting.

The *Bank of Maharashtra* v. *Pandurang Keshav Gorwadkar* [30]the Supreme Court had the occasion to discuss the rights of banks as secured creditors *vis-a-vis* the rights of workers and the jurisdiction of the DRT *vis-a-vis* the company liquidator. The court was of the view that section 19(19) of the RDDB & FI Act, came into effect only in cases where the liquidation proceedings of the company had started. Prior to it, the DRT was under no obligations to distribute what was recovered as per section 529 and 529 A of the Companies Act. But once winding up of the company were ordered, the responsibility of the DRT increases and it is bound to take into account the interest of workers and distribute the sale proceeds as per section 529 A of the Companies Act as after the company is in liquidation, a statutory charge is created in favour of workers. Even if the sale were made before the winding up order, but the proceeds were not disbursed to the secured creditors, the charge in favour of the workers would be there on the sale proceeds and they have to be disbursed as per section 529 A read with proviso to section 529 (1) (c) of the Companies Act. The DRT neither has the jurisdiction under section 19(9) of RDDB&FI Act which is limited to disbursement, nor the competence to adjudicate on the claims of the workers. It is for the liquidator to decide on the claims. However, pending such adjudication, the DRT may pay the bank the full (if no application for payment of dues of workmen has been made) or part of the recovered money, in proportion, as determined in accordance with illustration to 529(3) (c) subject to it giving it an indemnity bond of restitution when the claims of workmen as finally determined and the bank, were entitled to a lower amount in accordance with section 529(3) (c).

Constitutionality of state statutes for protection of depositors

In *Soma Suresh Kumar* v. *State of Andhra Pradesh*[31] the constitutionality of certain provisions of Andhra Pradesh Protection of Depositors of Financial

30 2013) 7 SCC 754.

31 (2013) 10 SCC 677.

establishments Act, 1999 were challenged on ground of the matter being within entry 45 of Union List *i.e*., banking. The petitioners were directors of a cooperative bank which was wound up when after inspection it was found that they had misappropriated money of depositors by creating false documents. The court, took into account its earlier judgements in *K.K. Bhaskaram* v. *State*, represented by its Secretary, Tamil Nadu[32] and *New Horizon Sugar Mills Ltd. V Government of Pondicherry*,[33] wherein it held that the equivalent Tamil Nadu, Maharashtra and Pondicherry Legislations were not in pith and substance dealing with entries 43-45 of Central List, but with entries 1, 30 and 32 of State List *i.e*., maintenance of public order, money lending and moneylenders and incorporation, regulation and winding up of corporations not specified in List I. Inexplicably, it also quoted with approval the part of *New Horizon Sugar Mills* case judgement which also found that the Pondicherry Statute was protected by article 254(2) of the Constitution.

Nature of RBI directions and internal circulars

In *State Bank of Travancore* v. *Vasantha Kumari*,[34] the Kerala High Court looked into the nature of directions issued by the Reserve Bank of India under section 21 and section 35 A of the Banking Regulation Act, 1949. The case related to educational loan given for nursing studies. As per RBI guidelines on the Model Educational Loan Scheme, no security was to be insisted upon for loans upto Rs. 4 lakhs. Collateral security, assignment of future income or having a guarantor (parent or third party) was to be taken where the value of loan exceeded rupees four lakhs. The father was a co-obligor in the case and the value of loan was less than four lakhs. The issue before the high court was whether the father could be made liable when he was made a co-obligor ignoring the RBI guidelines in this respect. While agreeing that waiver would be ineffective if an illegality was involved, the court took guidance from the Supreme Court decision in *BOI Finance Ltd.* v. *Custodian*,[35] wherein it was held that the RBI guidelines though binding on the banks were only directory in nature. Thus, their violation would not invalidate the act and would merely invite possible penalty under section 46 of the Banking Regulation Act.

In *M/S North Eastern India Trust for Education and Development* v. *Union of India*, [36]the question was posed to the Gauhati High Court as to whether a writ of mandamus could be issued to public sector financial institutions to conform to the RBI guidelines. The case related to RBI guidelines on One Time Settlement. While the petitioner's case was within the purview of it, its application was rejected on grounds that the value of collateral security was more than the due amount. The high court referred to the decisions of Supreme Court in *Sardar Associates* v. *Punjab and Sind Bank* [37] wherein it was held that public sector banks were 'state'

32 (2011) 3 SCC 793.

33 (2012) 10 SCC 575.

34 III (2013) BC 332 (Ker).

35 (1997) 10 SCC 488.

36 IV (2013) BC 646.

37 (2009) 8 SCC 257.

within the meaning of article 12 of the Constitution. Hence, they could not adopt a discriminatory attitude, which meant that the grounds which they cite for rejecting an application ought to be rational and should not display a departure from RBI guidelines which are binding on the concerned bank.

In *Ram Umrao* v. *Managing Director, Indus Ind Bank Ltd*. [38]the Allahabad High Court came across with the highhandedness of the bank. Not only was the recovery agent was not appointed by the bank, neither was a recovery agent appointed as per RBI guidelines, not did the agency taking possession act in accordance with RBI guidelines. On top of it the bank was too callous in issuing notice as the notice was to a person other than one whose vehicle was seized. To cap it all, it was observed that the amount due from the debtor would gallop upwards with every notice, from a figure around rupees one lakh it became over rupees five lakh in under a month without any explanation. The court was not only constrained to order the return of vehicle but also ordered the bank to pay the petitioner exemplary cost of Rs. one lakh.

B. *Anitha* v. *Manager, Punjab National Bank* [39]did not relate to RBI guidelines but bank's own circular. The circular dealt with post sanction supervision and nowhere it stated that good academic performance at school level be taken into account. The Madras High Court did not consider the fact that the word 'loan' connotes a judgement on the part of lender as to whether it could be repaid and stopping the loan at subsequent academic non-performance would still not be sufficient to repay the amount lent till that point. In its view, the circular listed the grounds which could be looked into while sanctioning loans and no other grounds could be imported by the branch. In its view, past academic performance was not necessarily a reflection of subsequent performance and cited the example of Dr. Ambedkar.

Bank's duty of confidentiality

Bharathi Amma v. *Canara Bank* [40]relates to scope of section 45ZB of the Banking Regulation Act, 1949. As per it, a bank could not entertain any claim on a deposit other than that of the person in whose name the deposit was held. Unless a decree, order or certificate of a competent court is produced. But for doing so one needed the details of an account. A successor of the deceased could obtain a succession certificate only if he or she knew the details of the account. The court held that section 45ZB was no barrier to a bank furnishing details of the account to the legal heirs of the account holder.

Kotak Mahindra Bank Ltd. v. *Hindustan National Glass and Ind. Ltd.* [41]was a set of three cases which came in appeal from Bombay High Court and Calcutta High Court involving interpretation of the term 'wilful defaulter' as used in the RBI

38 AIR 2013 115.

39 III (2013) BC 82.

40 IV (2013) BC 296.

41 (2013) 7 SCC 369.

Master Circular on Wilful Defaulters issued in 2008. While the Bombay High Court, taking the help of other Master Circulars issued by the RBI held that the term lender could not be construed in isolation and that the circulars on asset, prudential norms *etc*., too had a bearing on it. Therefore, the term 'wilful defaulter' would also include someone whose repayment obligations to a bank were not necessarily that of repayment of loan, could also include a client who has to repay the dues to a bank calculated on the derivative transaction it has entered into with the bank. Calcutta High Court had a totally opposite approach. In its view, the circular had penal consequences and hence the word 'lender' had to be construed narrowly and perforce can only be applicable where a loan has been provided and therefore, payment for facilities extended by a bank, as in case of dues under a derivative transaction were outside the scope of the word 'lender' used in the circular, which in turn meant that such client of the bank could not be regarded as a 'wilful defaulter'. The Supreme Court found fault with both the approaches. While one was too narrow and ignored relevant material, the other could not be commended as it took account of extraneous sources which were unrelated to the context in which the Master Circular was issued. Tracing the history of the circular, the Supreme Court found that the circular was the result of instructions issued by the Central Vigilance Commission which wanted that cases of wilful default above Rs. 25 lakhs, not just by borrowers, be reported so that the defaulting party does not exploit different parties due to lack of reporting. Further, the first scheme issued by RBI pursuant to the instruction related to both funded and non-funded facilities. The court found support for its view in section 45A(c) of RBI Act which provides that 'credit information' also means any other information RBI considers relevant for orderly regulation of credit and credit policy. Hence 'wilful defaulter' includes not just a defaulting borrower, but anyone who has payment obligations to bank whether as a guarantor or under derivative transactions, as they too have substantial bearing on credit and credit policy. In its view a statute is not a penal statute merely because it suggests action under a criminal statute as the circular did. It also did not find much force in the plea that section 45E of the RBI Act and the implied contract of confidentiality between a bank and its customer prevented a bank from furnishing information on a default in derivative transactions. Section 45c of the Act made it mandatory for the bank to furnish any information which the RBI asked for and section 45E(2)(a) provided that the section would not apply to information disclosed by a bank what it had furnished to RBI and for which it had RBI's prior permission.

Nature of bank draft

In *Mega Electrical DihangEdutech Infrastructure Pvt. Ltd.* v. *State of Assam*,[42] the Gauhati High Court in addition to the other issues had the occasion to look into the nature of a bank draft. On basis of authorities it summarised the law relating to it. It broadly laid down following propositions-

i. The relationship between purchaser of draft and bank is that of debtor and creditor and therefore at anytime before giving to payee, he

42 I (2013) BC 115.

can approach the bank to cancel it and pay him back the money, but not after delivery to payee.

ii. The bank issuing the draft cannot refuse to pay unless it reasonably suspects the identity of the person demanding payment. However, the Gauhati High Court added a doubt, where it read in the authorities that where the sole object of draft was to transmit money a fiduciary relationship was created and purchaser of draft can countermand only if bank had not parted with money held by it as agent. This has created uncertainty as to whether the purchaser could countermand even if he has parted with the draft. The issues of bank as a fiduciary arose in cases of bank insolvency, but the brush of the High Court is broader.

Amalgamation of banks

In *Reserve Bank of India* v. *Nedungadi Bank Ltd.*[43] an interesting question arose as to the effect on criminal proceedings under Banking Regulation Act after a defaulting bank has been compulsorily amalgamated with another bank. In this case, Nedungadi Bank and its Chairman were being prosecuted under section 46 of the Banking Regulation Act. Subsequently, Central Government declared a moratorium on all proceedings under section 45 of the said Act and thereafter Reserve Bank of India prepared a scheme for amalgamation with Punjab National Bank which the Central Government approved and thereafter notified. The question was what would be the effect of amalgamation on the criminal proceedings.This amalgamation is different from other mergers and amalgamation, where shareholders vote. The amalgamation with transferee bank happens to save the depositors. And the proceedings related to violation of regulations which was the reason for which the amalgamation scheme was prepared by the very regulator which was also prosecuting. Despite such extenuating circumstances, the Kerala High Court took a legalistic view and held that continuation of prosecution would depend on the terms of the scheme. The result would be that a penalty imposed on Nedungadi Bank, which was amalgamated with Punjab National Bank, would be paid by Punjab National Bank though Punjab National Bank stepped in as a white knight to save the depositors of Nedungadi Bank at the instance of Reserve Bank of India. It is an incongruous result and may have the result that the banks would in future be reluctant to step in unless the regulator gives an undertaking to abstain from prosecuting the transferee bank for acts of transferor bank.

Bank frauds

In *Ashok Amritaj* v. *Reserve Bank of India*,[44] the Madras High Court had to adjudicate on culpability of bank officials in defrauding the famous tennis player. The petitioners had deposited money with the bank in fixed deposits which, when he went back to claim on maturity, was told to have already been paid as per his instructions. The manner of payment absence of proper authorization letter, self-evident forgery and non-compliance with bank's own internal manual and contract

43 II (2013) BC 235.

44 I (2013) BC 323.

in relation to fixed deposits suggested complicity of bank staff. But the bank refused to pay pleading complicity of depositor and while it was not only parsimonious with truth in its pleadings, but also took the plea that since it involved disputed facts, the proper forum was the civil court. The high court from the facts on record observed the fraudulent manner in which the depositor was deprived of his money, which was with collusion of bank officials and for which a criminal complaint had been filed. As to whether a writ was maintainable or not, the high court observed the jurisdiction was discretionary and the fetters on its exercise were its own. Finding force in the decision of Supreme Court in *Hyderabad Commerce* v. *Indian Ba*nk,[45] it held that if the fact of unauthorized transfer was admitted, and then there was no dispute as to the bank's liability. So it ought to pay the fixed deposits to the petitioner subject to indemnity bond being executed by him. The conduct of the bank in the case and active suppression of facts as well as their misrepresentation did not go unnoticed and the court ordered it to pay exemplary costs to the petitioners.

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)

Hearing to defaulter under section 13 (3A).

Kerala Malabar Sand Stones (P.) Ltd. v.*Catholic Syrian Bank Ltd*.[46] is on the meaning of word 'representation' used in section 13(3A) of the SARFAESI Act. The petitioner, who had obtained loan for a stone crusher unit, was unable to commence operations in time due to various obstacles put in by the local populace, including physical obstruction, denial of necessary license from local panchayat *etc*. It was able to commence operations after it sought the intervention of the high court, which ordered police protection. The delay obviously had an adverse impact on the financial health of the loanee, causing it to default. On the bank's notice, the representation which requested the bank to not declare it a wilful defaulter and to regularize its account by rescheduling the repayment of debt, explaining the circumstances was summarily rejected. The contention of the bank was that the opportunity to represent was limited and with reference to the dispute *i.e.*, liability to be satisfied, property to be proceeded against and other such lapses by the lender. The court, on reading section 13(3A) of the Act, could not read any such limitation. The term used by the Act is 'representation or objection'. While what the respondents pleaded would be covered by 'objection', if one limited the reading of the Act to that, then the word 'representation' would be rendered otiose. Hence the bank ought also to look into also the extenuating circumstances which rendered timely repayment difficult. It is worth noting here that the borrower did not forsake its liability to repay. It only wanted a rescheduling of the repayment schedule.

Period within which action could be taken under section 13(4)

In *Zephyr Exports Pvt. Ltd.* v. *Central Bank of India* [47]the issue before the Calcutta High Court was that, after a notice was given under section 13(2) of the

45 (1991) Supp 2 SCC 340.

46 AIR 2013 Ker 25.

47 II (2013) BC 419.

Act, and the debtor has not paid within sixty days, whether we need to read in the requirement in section 13 (4) of the Act that measures that can be taken under it should be followed up within a reasonable period of time. The court found itself unable to agree with this proposition. The secured creditor had the right to initiate measures till the asset remained a non performing asset and the debtor did not lose the right to repay after the expiry of the notice period.

According to Karnataka High Court in *Krisanagowda* v. *Chief Manager, Kotak Mahindra Bank,*[48] there is a limitation in this right of the secured creditor. The limitation is that the secured creditor before taking possession ought to give a notice to the debtor under Rule 8 of the rules framed under SARFAES Act, which would specify the date when the creditor proposes to take possession. According to high court, the debtor in has time till the date of possession to pay the debt.

Section 13(a) of SAFAESI Act

In *Chemstar Organics Ltd.* v. *Bombay of Baroda*[49] Delhi High Court had the occasion to elaborate on the extent of defence available under section 13(a) of the SARFAESI Act, which provides that in case where there are more than one secured creditors or joint financing of an asset by secured creditors, no creditor could take action under Section 13(a) without the consent of three fourth of the creditors. In the view of the court, this was not for the benefit of the debtor, but for the creditor and hence it was unavailable as a defence to the debtor. Further, the court pointed out, if a property was secured to one creditor separately, merely because he was one of the creditors to the debtor did not mean that for enforcing his security interests as per section 13(4) of the Act, he needed the consent of three fourth of creditors who had no interest in the property.

In *Jagdish Singh* v. *Heeralal*[50] a plea was taken before the Supreme Court that before any measures were taken by the lender under section 13(4) of the SARFAESI Act, there was no bar on the borrower approaching the civil court. The court was not sympathetic to this line of argument and pointed out that section 34 of the Act not only bars jurisdiction of civil court on any matter the DRT is empowered by or under the Act, but also prevents the issuance of any injunction in respect of any measure taken or to be taken pursuant to the powers conferred by the Act. The bar is on all cases which DRT could take cognisance of.

Despite there being a SARFAESI Act for the help of secured creditors, the working of the DRT and Debt Recovery Appellate Tribunal (DRAT) do many a times act as a spoke in the wheel for faster recovery of debt. In *Standard Chartered Bank* v. *Dharminder Bohi* [51] the Supreme Court was forced to comment on the shortcomings in the functioning of these tribunals. In the case, the DRAT not only sat over an appeal for four and half years but gave an order which was 'laconic'. Taking into account the purpose of the Act, adjournments, in its view, should be

48 AIR 2012 Kant 116 R.

49 I (2013) BC 513.

50 (2013)13 SCALE 359.

51 (2013)12 SCALE 124.

an exception and not routine. Also, since the DRT and DRAT were the creation of statute, they could only exercise powers within the statute. In the case, while putting its seal on the compromise between the auction purchaser and borrower, DRAT gave the auction purchaser liberty 'to file action against the bank for any omission committed by it'. The observation was uncalled for and the DRAT order could not be justified either under section 19 of SARFAESI Act which talked of compensation to borrowers or under section 19 (25) of RDDBD&FI Act which gives it power to prevent abuse of its process or secure ends of justice.

An interesting issue arose before the Madhya Pradesh High Court in *Krishna Trading Co.* v. *Vyavisayik Evam Audhyogik Sahakari Bank Ltd.*[52] The Central Government, pursuant to the powers vested in it under section 2(1) (c) (v) of the SARFAESI Act, notified that cooperative banks, as defined in section 56(c) (i) of Banking Regulation Act were Banks for the purpose of SARFAESI Act. The petitioner's argument was two fold. Firstly, a cooperative bank is a cooperative society and not a banking company. For this reason section 56 of the Banking Regulation Act has made banking regulation applicable to cooperative societies primarily engaged in banking, but cooperative banks could not have been notified by Central Government. For this proposition, the petitioner relied upon the judgement of Supreme Court in *Greater Bombay Cooperative Bank Ltd*. v. *United Yarn Tex. (P) Ltd.*[53] The court found the plea specious and ineffectual. Agreeing with the Supreme Court that a cooperative bank could not be a banking company, which BR Act does not seek to make one, if the Central Government had the power to notify and section 2 (1) (c) (v) or SARFAESI Act. Then without contesting the Central Government's power to notify one could not challenge the notification as the power vested in Central Government would only expand the category. The second plea was that there already was a special dispensation available to cooperatives for recovery under Madhya Pradesh Cooperative Societies Act, 1959. The court pointed out that merely because an entity had some special powers and privileges did not mean that Central Government could not bestow upon it additional powers for recovery which was available to others. The same issue cropped up before the Orissa High Court in *Smt. Manorama Mohanty* v. *The Authorized Officer the Urban Cooperative Bank Ltd.*[54]The high court pointed out that the decision of the Supreme Court in *Greater Bombay Cooperative Bank Ltd*. case was on the availability of remedies under the RDDB & FI Act and the scope of SARFAESI Act was different. The Act empowered the Central Government to notify any other bank and one had to understand that the word 'bank' had a meaning wider than 'banking company'.

Simultaneous proceedings under SARFAESI Act and RDDB & FI Act

The Supreme Court in *M/S Transcore* v. *Union of India*[55]held that SARFAESI Act and RDDB & FI Act are complementary to each other. There might be unsatisfied

52 II (2013) BC 424.

53 (2007) 6 SCC 236.

54 AIR 2013 Ori 86.

55 AIR 2007 SC 712.

debt after enforcement of security interest which may necessitate one to move the tribunal. Therefore, it had come to the conclusion that if a bank had initiated proceedings under RDDB'&FI Act, it was not barred from initiating proceedings under SARFAESI Act against the same borrower. But what if the bank had initiated proceedings under SARFAESI Act, could it later initiate proceedings against the same borrower under the same loan under section 19 of RDDB& FI Act. The reasoning of Supreme Court would seem to suggest that there was no barrier to it. But the High Court of Patna differentiated the two situations in M/s *Purnea Cold Storage* v. *State Bank of India*[56] it looked into section 13 (10) of SARFAESI Act which provided that if secured assets were insufficient to satisfy the secured debt, the creditor, for the recovery of unsatisfied debt, could approach the DRT. This together with section 35, which gave SARFAESI Act provisions on overriding effect over other laws, helped it came to the conclusion that if proceedings had been initiated under SARFAESI Act, then the lender was barred from approaching DRT under section 19 of RDDB & FI Act.

Applicability of Limitation Act on proceedings under SARFAESI Act.

Section 17 and 18 of the SARFAESI Act provide for a time period within which proceedings could be initiated before DRT against the action of lender an appeal could be preferred to the DRAT respectively. A question which has arisen frequently is whether the prescribed respective outer time periods of forty five days and thirty days could be condoned by the tribunals by application or Limitation Act. Different high courts have taken different stands. While some (Andhra Pradesh and Bombay) have taken the view that Limitation Act is applicable to proceedings under section 17 and Section 18, some (Madhya Pradesh, Madras and Allahabad) have held that while limitation Act is applicable to proceedings under Section 18, and still others (Calcutta) are of the view that Limitation Act is inapplicable to any proceedings under section 17 or section 18. The issue cropped up before Punjab and Haryana High Court in *Surinder Mahajan* v. *DRAT*.[57] The court considered all the precedents on the issue and also the decisions or the Supreme Court on when one could say that provisions of Limitation Act were expressly or impliedly excluded by a statute. After considering them it pointed out that nowhere in the SARFAESI Act was it mentioned that provisions of Limitation Act were inapplicable to proceedings under it. SARFAESI Act was not a complete code in itself and section 37 of it recognised this as such. Further the procedure before the tribunal is the same as prescribed under RDDB & FI Act. This followed from section 17(7) and section 18(2). Since Limitation Act was applicable in proceedings before DRT and DRAT under RDDB & FI Act, it followed it should be applicable to proceedings under SARFAESI Act too. Division bench of Gujarat High Court in *Corporation Bank* v. *Jayshree Ben*[58] came to the same conclusion but a more limited issue of applicability of section 5 of Limitation Act to proceedings under section. 17.

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56 AIR 2013 Part 1; II (2013) BC 501.

57 (IV (2013)BC 531)

58 II (2013) BC 3927.

The Madras High Court in *Dr. Zubida Begum* v. *Indian Bank* [59]differed from the conclusion of Punjab and Haryana High Court and Gujarat High Court. In the case the issue was whether DRAT the power had under section 18 of the SARFAESI Act to condone delay. The court considered the judgement of Supreme Court in *Nahar Industrial Enterprises Ltd.* v. *HongKong and Shanghai Banking Corporation*[60] (2009 8 Section 646 that the tribunals constituted under the RDDB& FI Act were not courts and hence did not have the inherent powers of the civil courts. Thereafter, the high court saw the difference in the scheme of section 18 of SARFAESI Act and section 20 of RDDB&FI where proviso to 20(3) of RDDBD&FI Act gave specific power to the tribunal to condone delay and such a power was not mentioned in section 18 of SARFAESIAct. Since right to appeal was a statutory right, it would be subject to the limitations which the statute provided for it. The fact that the tribunal was not given power to condone delay was not surprising as the Parliament when enacting SARFAESI was taking into account the ineffectiveness of RDDB &FI Act to solve the problem of non-performing assets. On these considerations Madras High Court came to the conclusion that section 5 of Limitation Act was inapplicable on proceedings under section 18 of SARFAESI Act.

Time by which the borrower could redeem the security.

The borrower is given time under section 13(4) time to repay the debt. On its inability to do so, the creditor takes further action. On conduct of auction as per the Security Interest (Enforcement) Rules and deposit of sale price by the auction purchaser, does the borrower forfeit the night to redeem, even if the sale has not been confirmed by the creditor? This interesting issue arose before Division Bench of Andhra Pradesh High Court in *M/S India Finlease Securities Ltd.* v. *Indian Overseas Bank.*[61] Rejecting the plea that on deposit of sale price, it was mandatory to confirm the sale, the court pointed to section 13(8) that if before the date fixed for sale or transfer, all the dues of secured creditor are tendered then the secured asset shall not be sold or transferred and no further steps for its sale or transfer shall be taken. Therefore if before day fixed for sale, amount is tendered, sale proceedings shall be stopped and no auction conducted. But the borrower has another chance of redemption after conduct of auction *i.e.*, before confirmation of sale by the secured creditor or issuance of sale certificate by authorized officer under Rule (9)6. Acceptance of the bid by the authorised officer was not the equivalent of confirmation of sale by secured creditor on the basis of which the authorised officer issued a sale certificate.

Rights of purchaser of secured property *vis-à-vis* the secured creditors

While the secured creditor has rights against the borrower to take possession of secured property and thereafter sell the same if the debt remains unsatisfied, in effecting the sale he has to behave fairly in not only getting the best price but also

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59 I (2013) BC 67.

60 (2009) 8 SCC 646.

61 AIR 2013 AP 10.

to be upfront with the purchaser about the any defects in title it is aware of *Canara Bank* v. *Palco Recycle Industries Ltd*.,[62]the bank, though being aware of attachment of the secured property by the provident fund authorities for the provident fund dues, sold the property as being free of all encumbrances. The Gujarat High Court put it upon the bank the burden of satisfying the said dues.

Third party rights in secured property

In *Ratan Kumar* v. *State Bank of India*,[63] the Allahabad High Court clarified that an auction purchaser steps into the shoes of the owner and his rights are subject to the same limitation which the owner's right were. So if the property was subject to prior tenancy rights, which flowing from a special statute were not overridden by section 35 of SARFAESI Act, the auction purchaser's right in the property will also be subject to them.

Forfeiture of deposit by auction purchaser

The Madras High Court, in two different cases, *R Shamugachandhan* v. *Chief Manager, Indian Bank Asset Recovery*[64] and *Authorised Officer* v. *Tetrahedron Ltd.*[65] bought into sharp focus the question of bank's ability and duty of forfeiture of money deposited by successful auctioneer's purchaser and its rights on it. In the former case, the court distinguished between earnest money and the amount required to be deposited by successful bidder. While the Security Interest (Enforcement) Rules did talk of forfeiture of the latter if the successful bidder did not pay the rest of the 75% of the bid amount, no provision was made for former and so unless the auction notice provided for it, it could not be forfeited. It is an incongruous result and court did not consider whether the nature of earnest money changes as successful bidder is required to immediately deposit 25% of the bid amount and this could be regarded as part of the same. In the latter case the court found that the borrower was the ultimate beneficiary of the bid. The 25% of the bid amount should be forfeited if the successful bidder did not deposit the amount within the given time for no justifiable excuse. Further, since the bid was conducted at the cost of the borrower and for his property and there was no provision like rules under IT Act where forfeited amount was for the benefit of the government, it was only fair that it should be adjusted against the loan account. Allowing the bank to keep it on its own account would amount to unjust enrichment.

Binding nature of procedures under security interest [enforcement] rules

The property which was given as security to the lender is essentially that of the borrower. When the lender takes possession or the property and sells it, he has to take into account the interest of the borrower and therefore seek the highest price for it as a trustee for the borrower and not be satisfied with the price which is just sufficient to satisfy the loan. The Security Interest (Enforcement) Rules, 2002

62 AIR 2013 Guj 50.

63 AIR 2013 All 115.

64 II (2013) BC 218.

65 I (2013) BC 104.

have been framed so that the lender acts to set the best price for the secured asset. This was bought into focus by Madhya Pradesh High Court in *Shikha Graha Nirman Sahakari Sanstha* v.*Raina Kataria.*[66]The court was forced to observe that there appeared to be collusion in the sale as Rule 8 of the Security Interest (Enforcement) Rules, 2002 were not only not followed, the entries in auction register appeared to show that really speaking no auction was held. Also the required 50 days' notice period was not given for auction. Refusing to interfere with the orders of the tribunal, it also referred the matter to police for investigation as to whether any offence was committed.

Banker's lien

The bank has a right of lien over its customer's articles which the bank possesses in the course of its banking business. In the same vein, it can exercise lien over its customer's deposit, if it does not exercise its right of set off, if debt is due from its customer. But this right of lien is subject to the requirement that there should be no third part interest in the property or deposit. This was bought home by the Madras High Court in *Mrs. N. Sumath and Mr. L. Namachivayam* v. *Authorised Officer, Laxmi Vilas Bank.*[67] The high court had to point out to the bank that a joint deposit even if it is either or survivor, has two claimants to the deposit and the right of one of them could not be taken away merely because the other account holder was a guarantor to an unsatisfied debt. The high court did not so into the question as to whether the bank could exercise him over its own liability.

III CONCLUSION

The courts, taking into account the intent of the SARFAESI Act and RDDB&FI Act, have sought to remove the interpretational hurdles put up by the delinquent borrowers in their smooth working. While protecting the right of debtor to the residual value of the secured property as its owner, the intent of the two statutes was not compromised. So jurisdictional issues were generally resolved in favour of DRT, while the discretion of recovery officers was reined in. However the courts are unsure as to what extent the interpretation of powers of DRT, taking into account the intent of the Parliament, should be recognised or what the intent was. An example is the debate on application of section 5 of Limitation Act to section 17 and section 18 of SARFAESI Act.

While the courts have removed hurdles in recovery by hands off approach, it is in the arena of exercise of business judgement by the public sector banks that they have become proactive. Lending involves a judgement of repayment abilities, and internal circulars are only for guidance. Circulars do not create a public right and were not intended to. RBI guidelines are for better management of banks. RBI does not have the power to force the banks to abandon their contractual rights in the name of regulation. Guidelines for One Time Settlement are enabling and binding

66 AIR 2013 MP115.

67 II (2013) BC 99.

only in the sense, that settlements entered into contrary to it are questionable. But at the end of the day the question still is whether the bank has hopes of recovering its money or not, for which it is still the best judge and value of the security is a good measure of it. There are three ways to tackle the NPA problem. Firstly, following of best practices at the stage of lending with the ability to repay being the sole criterion. Secondly, removing incentives to non-payment of dues and thirdly, making the debtor stand by his bargain by enabling creditors in taking speedy legal action. SARFAESI Act and RDDB & FI Act deal with only the last.