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BANKING AND INSURANCE LAW

*Susmitha P. Mallaya**

I INTRODUCTION

REMARKABLE EFFORTS have been initiated by the legislature as well as judiciary to safeguard the interests of banking institutions after estimating an increase in banking frauds as well as the Non-Performing Assets of the banking sector from the past years. In continuation of the same, in the year 2017, apex court delivered two landmark decisions, among others which dealt with the consideration of bail application in cases involving money laundering and another with regard to constitutionality of Insolvency and Bankruptcy Code, 2016. It tried to bring a balanced approach to protect the interests of investors and banking institutions on the one side and to punish the culprits and fraudsters on the other. However, an analysis of the decisions of courts including the high court and Supreme Court is required considering the fast economic changes occurring in the international as well as domestic arena in the contemporary scenario. Selected decisions have been discussed in this chapter to provide an insight in this fast emerging field of economic laws.

II SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 (SARFAESI)

One of the pivotal challenges faced by banking sector in India is the slow pace of recovery of defaulting loans advanced to the customers by banks which results in mounting levels of non-performing assets. It is very unfortunate to observe that inspite of the various legislative measures adopted by the Government based on the recommendations of Andhyarjunia Committee as well as Narasimham Committee I & II, the burden of judiciary to decide the cases under this legislation is increasing every year. In the year 2017 also, the courts in India dealt with various issues cropping up from the provisions of this legislation, though many are reiteration of the same settled principles by the courts. Thus, the apex court in *M.D. Frozen Foods Exports*

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Pvt. Ltd. v. *Hero Fincorp Ltd*.,[1] decided on the question of overriding effect of certain provisions of SARFAESI legislation over the provisions of Arbitration and Conciliation Act, 1996. Earlier, the Court discussed and decided on the similar issue though it was on a different legislation.[2]

Generally, borrowers get their loan sanctioned from the banks in haste and when the time to repay the same, come the problems they face in repayment. They adopt all kinds of techniques to delay the repayment of money advanced by banks. In this case, the court applied the principle of doctrine of election and over ruled the decisions of the High Court of Andhra Pradesh[3] and High Court of Orissa.[4] Thus, with respect to the question of application of any other legal proceedings along with the SARFAESI proceedings it upholds the views of full bench decision in *Sarthak Builders Pvt Ltd* v. *Orissa Rural Development Corporation Ltd,*[5] as well as *HDFC Bank Ltd* v. *Satpal Singh Bakshi,*[6] and the Division Bench decision of High Court of Allahabad in *Pradeep Kumar Gupta* v. *State of U.P*.[7] In the present case, the question addressed by the apex court is whether SARFAESI proceedings and arbitration proceedings will go hand in hand. The Court held that since the proceedings under the SARFAESI are in the nature of enforcement proceedings and arbitral proceedings are adjudicatory in nature secured creditor can proceed against other assets after determination of pending outstanding amount in case where secured assets are insufficient to satisfy debts and also the provisions of arbitration are not inconsistent with provisions of SARFAESI. The apex court rightly emphasized the fact that any impetus to the industrial development of the country depends on the encouragement provided to the banks and financial institutions to formulate a liberal policy for granting of loans coupled with a quick and efficacious recovery process. At present, one of the reasons for the growing rate of NPA in the banking sector is lack of proper implementation of an effective mechanism under SARFAESI Act with regard to the recovery of the loan advanced to the customers when default is made by them.

Another question raised in this case was whether the lender can invoke the provisions of SARFAESI Act when its notification as financial institution under section 2(1)(m) has been issued after the account became an NPA under section 2(1)(o) of the Act. The Court answered the question by considering the objective of SARFAESI Act along with the rationale applied by the Parliament while implementing the Act to financial institutions and observed that the scheme of the SARFAESI Act, is really to provide a procedural remedy against security interest already created. Therefore, an

1 AIR 2017 SC 4481.
2 Susmitha P. Mallaya, "Banking and Insurance", LI *ASIL* 105 at 106 (2015).
3 *Deccan Chronicals Holdings Ltd* v. *Union of India*, AIR 2014 AP 78.
4 *Subash Chandra Panda* v. *State of Orissa*, AIR 2008 Ori 88.
5 AIR 2014 Ori 83: 2014 SCC OnLine Ori 75.
6 2013 (134) DRJ 566 (FB): 193(2012) DLT 203.
7 AIR 2010 All 3.

existing borrower, who had been granted financial assistance was covered under section 2(f) of the Act as a "borrower". Sanjay Kishan Kaul, J. said:[8]

> [N]ot only this expression, the definition clauses dealing with 'debt securities', 'financial assistance', 'financial assets', etc., clearly convey the legislative intent that the SARFAESI Act applies to all existing agreements irrespective of the fact whether the lender was a notified 'financial institution' or the date of the execution of the agreement with the borrower or not. The scheme of the SARFAESI Act sets out an expeditious, procedural methodology, enabling the bank to take possession of the property for non-payment of dues, without intervention of the court. The mere fact that a more expeditious remedy is provided under the SAFAESI Act does not mean that it is substantive in character or has created an altogether new right.

Hence, the decision of the apex court to upheld the application of provisions of the SARFAESI Act irrespective of the date on which a debt is declared as an NPA and treating SARFAESI Act and Arbitration and Conciliation Act, 1996 as complementary to each other is justified. However, the problem remains the same as to the misuse of the provisions of the legislation by the borrowers especially the corporate borrowers who makes default in the loan advanced to them and knocking the doors of courts till apex court though the Parliament in the legislation of SARFAESI Act has provided for the speedy recovery of the debt due from the borrowers by following certain procedure prescribed under the legislation and without the intervention of the courts to enforce the rights.

Guarantor under definition of 'borrower' under SARFAESI Act

The question whether a guarantor of any mortgage or pledge as security for financial assistance can be effectuated as 'borrower' under the SARFAESI Act was discussed by the High Court of Gujarat in *Sagar Innovative(P) Ltd* v. *Punjab National Bank.*[9] In this case it was contended by the petitioners that Securitization and Reconstruction Company has no jurisdiction to take measures under section 13(4) of SARFAESI since they are not 'borrowers' but only 'guarantors'. This case is a bunch of petitions filed by various parties under articles 226 and 227 of the Constitution of India being aggrieved by the action taken under the provisions of the SARFAESI Act. The common issue raised by them, however, relates to the interpretation of the term 'borrower' under section 13 of the SARFAESI Act. It was argued that the action under section 13 of the Act could be taken only against the borrower who makes default in repayment of the loan and whose account with secured creditor is classified as NPA. Also they contended that there is no question of making any default or

8 *Supra* note 1, para 38.
9 [2017] 141 SCL 141 (Guj).

classifying their account as NPA and interpreted the term borrower under two categories, one is the borrower-in-fact and the other is borrower-in-law.[10]

On the otherside, it was argued that section 2(f) of SARFAESI defines 'borrower' which includes 'guarantor' also. 'Guarantor' signifies a person who has given any guarantee or created any mortgage or pledge as security for financial assistance granted by any bank or financial institution to whom it advanced loan. Moreover, the purpose to enact the SARFAESI Act was to reduce NPAs by adopting measures for speedy recovery of the financial assets by enforcement of the security interest. Hence, it can be presumed that the legislature could have intended that the Act would apply even to the guarantors/mortgagors and action can be initiated against them in case of default of making payment due from them.[11]

The high court held that a person who has given any guarantee or created any mortgage or pledge as security for financial assistance granted by any bank or financial institution, is a 'borrower' within the meaning of the Act and it would stand covered in section 13(2) and 13(4) for taking measures to recover secured debt.[12] The court relied on the statement of objects and reasons for enacting the Act and from the Scheme of the Act, it observed that if the guarantors or the mortgagors are taken to be excluded from the purview of the Act, it would run counter to the objects intended to be achieved by the legislature.[13] It emphasised:[14]

> The definition of 'borrower' takes in its sweep even a person who has given guarantee or created any mortgage or pledge as a security for the financial assistance granted by any bank or financial institution. The security interest means right, title or interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31. The creation of security interest to secure the debt of the bank or financial institution does not fall within section 31 of the Act. Security interest could be created under the security agreement as defined in section 2(zb) of the Act and on creation of such security interest, the debt of the bank or financial institution is secured. Therefore, a person who has given any guarantee or created any mortgage or pledge as security for financial assistance granted by any bank or financial institution, is a borrower within the meaning of 'borrower' under the Act.

10 *Id*. at para 5.
11 *Ibid*.
12 *Id*. at paras 11, 14.
13 *Ibid.*
14 *Id*. at para 10.

It made clear that the intention of the legislature was to apply provision of section 13 of the SARFAESI Act which provides for enforcement of any security interest to the guarantor or the mortgagor for recovery of the secured debt by enforcing security interest against them.

Stage of right to appeal of borrower

Borrower can avail right to appeal under section 17 of SARFAESI Act only after initiation of recovery proceedings. This writ was filed by *Aroma Chemicals Ltd* v. *Punjab National Bank,*[15] to quash the initial notice issued under section 13(2) of the SARFAESI Act as well as quashing the order which classified the account of petitioners as NPA. The High Court of Allahabad rejected the writ petition filed by the borrower and observed that the bank was cheated of its valuable security in the form of ready stock, hence, recovery proceedings cannot be set aside. It emphasized this view as:[16]

> It is apparent that the stock, which was in the nature of valuable security of the Bank has been eroded and the same has been surreptitiously removed by the petitioners. At present neither there is any stock nor sale proceeds have been deposited with the bank and thus, apprehension of the bank that the bank has been cheated of its valuable security, which was in the form of ready stock and which has not been removed even without informing the bank is justified and thus in this view of the matter also neither in law not in equity is the petitioners entitled to grant of any indulgence whatsoever.

The court also observed that the bank has not initiated any action under section 13(4) till the time of filing of this writ petition hence, this writ need not be entertained since the petitioners has a more effective and efficacious remedy available under section 17. [17]

Another relevant decision by the high court is in *Shyam Sunder Rohra* v. *Indus Ind Bank*,[18] where the High Court of Madhya Pradesh held that secured creditors cannot approach Chief Judicial Magistrate, seeking assistance to secure their assets and only Chief Metropolitan Magistrate and District Magistrate can be approached for taking possession of secured asset under section 14 of the SARFAESI to recover the debt and *Alpha Beta Shiksha Samiti (Regd), Jaipur* v. *State of Rajasthan,*[19] the High Court of Rajasthan held that right to appeal provided to "any aggrieved person"

15 AIR 2017 All 55.
16 *Id*. at para 31.
17 *Id*. at para 33.
18 AIR 2017 MP 36.
19 AIR 2017 Raj 81.

by insertion, could not be retrospectively applied. In this case the petitioner claimed tenancy rights and filed petition prior to amendment. It was held that he cannot avail the remedy provided by amendment.

III RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTIONS ACT, 1993

In *Narendra Plastic Private Limited* v. *DBS Bank Limited*,[20] the High Court of Bombay held that ex parte order cannot be set aside merely because summon was not issued on director at company's address in case of a recovery proceeding initiated under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI). As far as proceedings under the RDDBFI and SARFAESI are concerned, in exercise of the powers conferred under section 22(1) of RDDBFI Act, regulations have been framed, called as Regulation of Practice, 2010 (RP) of the Debts Recovery Tribunals for the States of Maharashtra, Gujarat, Goa and the Union Territories of Dadra and Nagar Haveli, Daman and Diu. Accordingly, regulation 19 relates to service of summon or notice. Regulation 19(4) of RP provides that if the summon or notice is served on the Secretary or the Director or other principal officer of the Corporation or the Partner of the Partnership Firm at its registered office or on the address of the Partnership Firm, it shall be good service. Also that if the notice is transmitted on the registered address of the company and even if not claimed shall also be termed as good service. Specifically, regulation 19(6) RP provides that where the summon or notice is returned with postal remarks such as 'refused'. 'unclaimed', 'not claimed', 'intimated' or 'intimation given', it may be declared that the summons or notice is served.[21] In this case the petitioners are trying to avoid the repayment of the loan advanced to them by the respondent bank. They were reluctant even to make the pre-deposit of the amount before the tribunal to entertain an appeal as per the mandate of the section 30A of the RDDBFI Act. Hence, they were also denied any equitable relief of reduction of the pre-deposit amount by the high court and refused to exercise extraordinary jurisdiction under article 226 of the Constitution of India.

Effect of Non-disclosure of pending litigations and encumbrances of sale of secured assets to auction purchaser

In *Shanmuganathan* v. *Authorized Officer, Indian Overseas Bank, Chennai*,[22] the High Court of Madras examined the effect of non-disclosure of pending litigations and encumbrances of sale of secured assets to auction purchaser during auction sale by the bank. The Security Interest (Enforcement) Rules, 2002, rules 9(9) and 9(10) provides that the authorized officer shall deliver the property to the purchaser free

20 AIR 2017 Bom 173.
21 *Id*. at paras 14 and 15.
22 AIR 2017 Mad 228.

from encumbrances known to the secured creditor on deposit money and that the certificate of sale issued under sub-rule (6) shall specifically mention that whether the purchaser had purchased the immovable secured asset free from any encumbrances known to the secured creditor or not. The bank in this case violated this mandatory provisions and petitioner who is the auction purchaser was put in trouble. This is a callous approach taken by a financial institution with regard to the sale of secured asset under the SARFAESI Act. It failed to put the auction purchaser in vacant possession of the property or to return the sale consideration paid about nine years back. The petitioner filed this writ petition to refund the sale consideration since the bank failed to disclosing encumbrances and pending litigations while selling secured property and retained the sale consideration of the purchaser without delivering property to him.

It is unjust from the part of bank to take this unreasonable attitude as well as objecting the maintainability of this writ petition filed for refund of money. The bank pleaded that purchaser for setting aside sale must approach DRT. However, the high court rejected this contention since the facts in this case are clear about violation of rules by bank. The court observed:[23]

> [T]he petitioner is a thirty (emphasis added as *third*) party to the loan transactions. He is neither a borrower nor a person claiming interest under the borrower. The petitioner is aggrieved by the failure on the part of bank to put him in possession of the secured asset inspite of paying the entire sale consideration about nine years ago. The bank violated the mandatory provisions of SARFAESI Rules by not disclosing the known encumbrances. There is no question of directing the petitioner to approach the DRT or other authorities notwithstanding the serious violations committed by the Bank. Since the facts are clear in the absence of disputed questions of fact, the Bank is not justified in its contention based on alternative remedy.

The decision of the high court is justified and it is in tune with the Supreme Court decision in *Bharat Sanchar Nigam Ltd* v. *Telephone Cables Ltd,*[24] where the court indicated the need for the Public Sector Undertakings to ensure fairness in all their transactions as well as in another decisions[25] where the court indicated the requirement to take bonafide measures to ensure maximum yield from secured assets for the borrowers.

The High Court of Jharkhand also took a similar approach towards the misrepresentation by bank in auction sale since it is the duty to disclose all relevant

23 *Id*. at para 26.
24 AIR 2010 SC 2671.
25 *J.Rajiv Subramaniyan* v. *Pandiyas*, AIR 2014 SC 1710.

facts in sale notice. However, in *Kumar Rohit* v. *Allahabad Bank,*[26] the bank failed to disclose that the property put on auction sale was leased property and it belonged to Housing Board in the E-auction notice by the bank. Moreover, the property was not absolute property of borrower. Knowledge of the defect in property cannot be imputed to an intending purchaser and such covenants will not overcome fatal defect in auction notice. The court refused to accept the plea by the bank that even if property was a leasehold property, same can legally be put on sale for realizing Bank's dues under Securitization Act.

However, in another case on different facts, the Supreme Court in *V. Ganesan* v. *Canara Bank,*[27] held that auction sale of mortgaged property once confirmed by Recovery Officer and sale deed also executed, Debt Recovery Appellant Tribunal (DRAT) cannot set aside the confirmed sale on the ground that borrower is not left with any other property and he has already paid consideration to auction purchaser. Moreover, in the present case, DRAT was only in *seisin* of issue of transfer of proceedings and not decided merits of dispute. This is another scenario dealing with the sale of secured assets.

Power of Lok Adalat in passing interim order in pre-litigation with regard to the sale of secured assets under SARFAESI Act

In a very interesting case before High Court of Jharkhand in *Allahabad Bank* v. *Sunita Devi,*[28] the validity of interim order granted by Lok Adalat restraining bank from taking any further action in a pre-litigation stage of a case under SARFAESI Act was challenged. In this case, the bank has already taken symbolic possession of the mortgaged property under section 13(4) of SARFAESI Act. Moreover, an application for taking physical possession of the property through use of force was also pending before Deputy Commissioner, Bokaro under section 14 of the SARFAESI Act. Hence, in pursuance of the provisions under the SARFAESI Act, any court or authority other than DRT was precluded from passing any order of injunction in respect of action taken by the bank or financial institution. Therefore, the high court held that the action by the Lok Adalat in entertaining the application as a pre-litigation application and passing an interim order upon the Bank to maintain status quo and not to take further action against the guarantor was wholly without any jurisdiction. The court further held that the proceedings in the Lok Adalat are to be held in a spirit of conciliation and settlement. This action is a serious error of jurisdiction in the teeth of provisions of section 34 of SARFESI Act. It is to be noted that the respondent guarantor had also gone before the DRT against the action of bank in respect of auction sale of mortgaged property.

This interference by the Lok Adalat is not appreciable in the matters under sale of secured assets by the banks and financial institutions especially when the legislature and judiciary tries to reduce the complexities involved in the SARFAESI and help the banks for speedy recovery of non-performing assets.

26 AIR 2017 Jhar 65.
27 AIR 2017 SC 1972.

Power of Magistrate under SARFAESI Act

In *Bank of Maharashtra, Nagpur* v. *Additional District Magistrate,*[29] the High Court of Bombay held that while assisting secured creditor in taking possession of the secured asset, Magistrate is not empowered to determine the nature of asset secured. Magistrate is only duty bound to verify declarations and affidavit tendered by creditor and pass orders of taking actual possession. In this case the Magistrate determined the nature of secured asset to be agricultural land and denied bank to take possession of the land. This approach was held erroneous and hence the matter remitted for fresh consideration. This approach of high court has been based on the observations of the apex court decision in *Standard Chartered Bank* v. *Noble Kumar*,[30] where it stated that the satisfaction of the Magistrate contemplated under the second proviso of section 14(1) necessarily requires the magistrate to examine the factual correctness of the assertions made in such an affidavit but not the legal niceties of the transaction.[31] Similarly, in *Syndicate Bank through its Regional Manager, Patna* v. *Rajesh Kumar*,[32] the High Court of Patna held that powers of district magistrate under section 14 of SARFAESI Act is only to "assist, take or cause to be taken for such steps and use or cause to be used such force" as may, in his opinion be necessary. He is not adjudicatory authority rather he has to only assist and provide necessary police force if required.[33] The high court in this case set aside the adjudicatory order passed by the district magistrate initiating case asking both the parties to appear before him. The High Court of Allahabad also took the similar approach with regard to the application of section 14 of SARFAESI Act in *Lakshya Concosts Pvt. Ltd* v. *Bank of Baroda,*[34] the court held that section14 of the SARFAESI Act is procedural in nature and only empowers authorities to assist secure creditor in taking over possession of secured assets as per procedure contemplated therein. It does not empower authorities specified therein with any power to adjudicate in respect of any dispute pertaining to secured assets. It is a mere administrative power and will not amount to any delegation of power. The High Court of Gujarat in *Gruh Finance Limited* v. *District Magistrate*,[35] held that the role assigned to magistrate under section 14 of SARFAESI Act is of ministerial kind in rendering assistance. Merely on the ground that secured creditor had not approached with clean hands is not a ground for the magistrate to adjudicate the matter.

These cases decided by various high courts shows the proactive approach taken by the magistrate while the securitization cases are filed before them. There is a lack

28 AIR 2017 Jhar 118.
29 AIR 2017 Bom 92.
30 (2013) 9 SCC 620.
31 *Id*. at para 25.
32 AIR 2017 Pat 126.
33 *Id*. at para 10.
34 AIR 2017 All 172.
35 AIR 2017 Guj 172.

of clear understanding of the principles and spirit of the SARFAESI legislations by the lower judiciary. The high courts are expected to sensitize the judicial officers with regard to the powers vested to them under SARFAESI legislation in order bring the litigation in this area to the minimum and in turn held the higher courts to save their precious time and pending litigation.

In *Allahabad Bank* v. *Hemant Kumar Omprakash Malpani,*[36] the High Court of Bombay held that personal guarantee and hypothecation charges executed by directors of a company in favour of creditor bank is not covered under any exceptions in section 31 of the SARFAESI Act and hence civil suit in respect of said matter is barred. Civil court cannot grant any injunction or declaration restraining bank from taking measures against debtor for the enforcement of security interest. The directors cannot avoid their liability to pay dues to the bank as guarantors after resigning from the posts of directors and intimating it to creditor bank.

In *Pawan Kumar Poddar* v. *Bank of India, Rachi*,[37] High Court of Jharkhand decided on the rights of a tenant on the sale of immovable property in terms of rule 60 of the second schedule of the Income Tax Act as adopted under RDDBFI Act. In this case auction sale was confirmed in the case of recovery proceedings initiated by the bank. The tenant was holding tenancy in the property auctioned, he approached the court to set aside the sale of immovable property. The court though refrained from deciding the question with regard to the difficulty faced by the secured creditor on the one hand and the rights of tenants which are governed by state legislatures.

These cases depict the tactics taken by the defaulters of loan and the response towards the same by the courts which are appreciable in the interests of banking sector as well as to uphold the spirit of the SARFAESI legislation.

IV BANKING REGULATION ACT, 1949

In *Gorakhpur Steels & Metals Private Ltd* v. *Presiding Officer, Debts Recovery Tribunal*,[38] the High Court of Allahabad discussed the meaning of the word 'banking' under the Banking Regulation Act, 1949 (BR). It observed that in simplest form of banking business, "banking" as defined by section 5(b) of BR Act does not envisage any right to deal in securities which have been acquired at time of lending. Securities are only to ensure recovery of outstanding. On failure of borrower to honour commitment, it is open to bank to realize security. Plain language of said provision does not permit any other view on the matter.[39] The definition of 'banking' primarily denote the same meaning of accepting of deposits of money from public which is repayable on demand or otherwise, and permitting withdrawal of such deposits by

36 AIR 2017 Bom 208.
37 AIR 2017 Jhar 144.
38 AIR 2017 All 224.
39 *Id*. at para 17.

cheque, draft etc. The purpose of accepting such deposits of money is for lending or investment. The expression 'banking policy' means any policy specified periodically by RBI in the interest of (a)banking system (b)monetary stability and (c)sound economic growth as per section 5(ca) of BR Act. Policy has to be framed having due regard to interests of depositors, volume of deposits and other resources of the bank.[40]

V PREVENTION OF MONEY LAUNDERING ACT, 2002

In money laundering offences, money launderers remain one step ahead of the law enforcement agencies. It needs to signify at this juncture that it has been precisely the innovations adopted by these persons that resulted in extending the reach of anti-money laundering regimes to the new sectors of economy as well. The objective of the PMLA is to prevent this economic offence on the one hand and punish the culprits stringently on the other. Generally, being special legislation, the provisions of other statues are not applicable to decide the cases filed under this legislation. The Supreme Court in *Union of India* v. *Varinder Singh*[41] reiterated this principle that in cases related to money laundering 'jail is the rule and bail is an exception' for the offenders of this economic crime. The apex court set aside the bail granted by the high court and noted that section 45 of PMLA will have overriding effect on the general provisions of the Code of Criminal Procedure in case of conflict between them.[42] Also that the twin conditions for grant of bail specified under section 45 of the PMLA indicates that the legislature has carved out an exception for grant of bail by a Special Court when any person is under the age of 16 years or is a woman or is a sick or infirm. Therefore, these conditions laid down under section 45-A is binding on the high court while deciding the bail application relating to offence under money laundering. The provision relating to bail in money laundering cases is very crucial and the apex court strictly followed in its decisions in *Gautam Kundu* v. *Directorate of Enforcement (Prevention of Money Laundering Act)*[43] as well as *Rohit Tandon* v. *The Enforcement Directorate*.[44] In the case of *Rohit Tandon*[45] the bench consisting of Dipak Misra, CJ and A.M. Khanwilkar and D.Y. Chandrachud, JJ observed that "the consistent view taken by this Court is that economic offences having deep rooted conspiracies and involving huge loss of public funds need to be viewed seriously and considered as grave offences affecting the economy of the country as a whole and thereby posing serious threat to the financial health of the country. Further, when attempt is made to project the proceeds of crime as untainted money and also that the allegations may

40 *Id*. at para 18.
41 2017 SCC OnLine SC 1314.
42 *Id*. at para 34.
43 (2015) 16 SCC 1.
44 AIR 2017 SC 5309: 2017 SCC OnLine SC 1304.
45 *Ibid*.

not ultimately be established, but having been made, the burden of proof that the monies were not the proceeds of crime and were not, therefore, tainted shifts on the accused persons under section 24 of the Act of 2002. It is not necessary to multiply the authorities on the sweep of section 45 of the Act of 2002 which, as aforementioned, is no more res integra".[46]

However, in *Nikesh Tarachand Shah* v. *Union of India,*[47] the apex court moved away from its settled position with regard to the granting of bail to the accused. The present case however, for the first time challenged the constitutional validity of section 45 of the PMLA which imposes twin conditions for granting bail in the cases involving offences where the punishment prescribed is for a term of imprisonment of more than 3 years under part A of the Schedule mentioned in PMLA. The apex court ordered fresh trial in all cases in which bail was denied because of these conditions. "We declare section 45(1) of the Prevention of Money Laundering Act, 2002, insofar as it imposes two further conditions for release on bail, to be unconstitutional as it violates articles 14 and 21 of the Constitution of India". The bench consisting of R.F. Nariman and Sanjay Kishan Kaul, JJ considered the personal liberty of the persons languishing in jail and ignored the objective of the PMLA and failed to address the repercussions of granting bail for the accused in PMLA.

In PMLA, scheduled offences mentioned in Part A and Part B and the offences under section 3 and 4 need to be read together. PMLA is a special legislation and a complete Code in itself, hence, section 45 being part of a complete code cannot be separated, so that money that is laundered can be brought back into the economy and the persons responsible for the same will get punished. The expression "there are reasonable grounds for believing that he is not guilty of such offence" under section 45 provides an opportunity for the court to make prima facie assessment of reasonable guilt. This is one of the twin conditions mentioned for granting of bail in money laundering cases. The people involved in money laundering cases are generally, influential as they conduct these activities in a very secretive manner making it very difficult for the enforcement agencies to prove that the money laundered are "proceeds of crime". Therefore, making the provision for granting bail easy based on the arbitrariness in the scheduled offences under part A and part B needs reconsideration. In order to test the arbitrariness of the section 45 in violation of article 14 of the Constitution of India, the court relied upon the *State of Bombay* v. *F.N. Balsara*[48] especially the law which states that "while reasonable classification is permissible, such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the objects ought to be attained, and the classification cannot be made arbitrarily and without any substantial basis". On the other hand, the

46 *Id*. at paras 21 and 22.

47 AIR 2017 SC 5500: 2017 SCC OnLine SC 1355. Susmitha P. Mallaya, "Case Comment", XIX *ILI Newsletter* 23-24 (Oct-Dec., 2017).

48 (1951) SCR 682.

court overlooked the other principle of law laid down in the same case which states that "the presumption is always in favour of the constitutionality of an enactment, since it must be assumed that the legislature understands and correctly appreciates the needs of its own people, that its laws are directed to problems made manifest by experience and its discriminations are based on adequate ground and also that the principle does not take away from the State the power of classifying persons for legitimate purposes". In this scenario, the amendment made to the schedule under PMLA by which the entire Part B offences were transplanted into Part A by way of Amendment Act of 2012 of PMLA needs to be looked into. The object states, "(j) putting all the offences listed in Part A and Part B of the Schedule to the aforesaid Act into Part A of that Schedule instead of keeping them in two Parts so that the provision of monetary threshold does not apply to the offences". The court viewed the entire case from the angle of right to life and personal liberty of the person accused and referred various landmark decisions[49] and observed that there is an established trend to infuse the concept of due process in our constitutional jurisprudence whenever the court has to deal with a question affecting life and liberty of citizens or even a person. It is appreciable that the court upheld the fundamental rights of the accused persons and made an attempt to interpret the criminal justice principles in favour of the accused. It held that section 45 of the PMLA violated articles 14 and 21 of the Constitution. However, considering the technical and peculiar feature of offence of money laundering, declaration of section 45 of the PMLA as unconstitutional created a roadblock to book the culprits of financial crimes in tune with the international obligations to tackle the money laundering offence. The court viewed the seriousness of money laundering cases depending upon the amount of money involved.[50] Since there is no monetary limit fixed in schedule A, the court concluded that the likelihood of being granted bail was being significantly affected under section 45 by factors that had nothing to do with allegations of money laundering. The court would have done well if it answered whether the classification of offences under schedule A of PMLA as well as other offences is in consonance with the objects of the PMLA and if they were not in tune with it, could have struck down such classification instead of striking down the whole provision as unconstitutional.

This decision diluted the stringent standard once set up by the legislature and judiciary for granting bail in the cases relating to money laundering considering its peculiar nature which is a threat to the national economy in particular and society in general. There is a need to make money laundering *per se* a separate offence instead of compounding it with the scheduled offences mentioned in the PMLA. This will create the PMLA legislation more effective and the differential treatment to the persons accused of money laundering as discussed in this judgment will get addressed.

49 *Maneka Gandhi* v. *Union of India,* (1978) 4 SCC 494; *Sunil Batra* v. *Delhi Administration,* (1978) 4 SCC 494.

50 *Nikesh Tarachand*, *supra* note 31, *id*. at paras 29 and 30.

VI INSOLVENCY AND BANKRUPTCY CODE, 2016

Insolvency and Bankruptcy Code (IBC) was implemented by the Government with an objective to find appropriate solution for stressed assets and the National Company Law Tribunal (NCLT) was entrusted with the task to put in place mechanisms for proper resolution in a short time span. It was ascertained in due course that the earlier mechanism to address the issue of stressed assets and the recovery action by the creditors through special laws such as Recovery of Debts Due to Banks and Financial Institutions Act, 1993, SARFAESI Act, 2002, Sick Industrial Companies (Special Provisions) Act, 1985 have neither been able to aid recovery for lenders not aided for restructuring of firms. It was observed that instead of revival of sick industries the process created a protective shield for the debtors and nobody can recover money from them once they enter the process of revival. This in turn made non-performing investment become more non-performing as well as hindered banks from pursuing defaulters to repay the dues.[51]

When lenders are unconfident, debt access for borrowers is diminished. This reflects in the state of the credit markets in India. Secured credit by banks is the largest component of the credit market in India. It also aimed at Debt Recovery Tribunal and National Company Law Tribunal to act as Adjudicating Authority and deal with the cases related to insolvency, liquidation and bankruptcy process in respect of individuals and unlimited partnership firms and in respect of companies and limited liabilities entities respectively. The establishment of an Insolvency and Bankruptcy Board of India aimed to exercise regulatory oversight over insolvency professionals, insolvency professional agencies and information utilities. At the nascent stage of this legislation, several issues pertaining to constitutionality, legal validity of lawyer's notice, withdrawal of application after admission by the NCLT, relaxation of time period, definition and scope of 'dispute' under IBC were examined in various cases filed before the apex court.

The apex court in *Innoventive Industries Ltd* v. *ICICI Bank,*[52] decided the Constitutional validity of the IBC. This case is perhaps the first case decided by the apex court on the operation and functioning of the IBC. The court gave extensive ruling on several crucial issues raised before it relating to the implementation of the Code with an object that all courts and tribunals may observe the paradigm shift in the law engendered by insolvency and bankruptcy proceedings.

In this case ICICI bank filed an application before the NCLT, Mumbai to initiate corporate insolvency resolution process against the Innoventive Industries Ltd. This is the first application filed under section 7 of IBC on account of default made by the company in re-payment of amounts due under certain credit facilities availed from

51 For details refer the case *infra* note 52, *Id.* at para 16.

52 AIR 2017 SC 4084: 2017 SCC OnLine SC 1025. Susmitha P. Mallaya, "Case Comment", XIX *ILI Newsletter* 20-21 (July-Sep. 2017).

the bank. The company pleaded before the tribunal that the application filed by the bank stands suspended pursuant to a relief order passed by the Government of Maharashtra under the Maharashtra Relief Undertaking (Special Provisions) Act 1958 (MRUA) which provides to declare the industries overtaken by the state as 'relief undertaking' through government notification. The object of this state legislation is to protect the employment of the people who are working in such Undertakings. On the other hand, the IBC provides for overtaking of business of Undertaking by an 'Insolvency Professional' through a committee of creditors. Therefore, the company argued that since it is a 'relief undertaking' under the MRUA, provisions of IBC is not applicable. It also contended that no notice was issued to the corporate debtor to hear whether there is a default of payment by the company, moreover the ICICI bank had not taken the consent of the Joint Lenders Forum (JLF) before filing the Insolvency application. However, NCLT rejected these arguments by the company and admitted the insolvency application filed by the bank. It also declared moratorium and appointed an Interim Resolution Professional (IRP). National Company Law Appellate Tribunal (NCLAT) upheld the order of NCLT and dismissed the appeal filed by the company. It is clarified that adherence to principles of natural justice would not mean that in every situation the NCLT is required to afford reasonable opportunity of hearing to the corporate debtor before passing its order and held that while deciding applications under section 7 of IBC, NCLT need only to look at ingredients of the section provided. It also held that there was no repugnancy between the objects of the MRU Act and the IBC since the objects of the MRU Act and the IBC operate in different fields viz. prevention of unemployment of the existing employees of a relief undertaking and protection of creditors of the said entity, respectively. The company approached the apex court against this order of the NCLAT. The apex court held that once an Interim Resolution Professional (IRP) is appointed to manage the company, the erstwhile directors, who are no longer in the management, cannot maintain the appeal on company's behalf – and since in the present case, *Innoventive* was the sole applicant – the appeal was not maintainable. However, it refused to dismiss the appeal on this aspect alone, observing that it is delivering a detailed judgment so that all courts and tribunals may take notice of the 'paradigm shift in law'.

This positive step from the part of apex court to speed up the insolvency process in the interest of economic growth of the country is commendable. It recognized that the Insolvency Code has brought about a paradigm shift in law and economic policy and undertook an in-depth examination of IBC provisions dealing with corporate insolvency resolution. It directed both the NCLT and NCLAT to keep in mind the principle objective of IBC and strictly adhere to the time frame within which the matter needs to be decided. This elaborate judgment brings more clarity to the provisions of the IBC which will have dominance over other laws in force, however, a negative perspective of this ruling is that once an IRP has been appointed, the powers of the board of director stand suspended which in turn curtail the right of directors to maintain an appeal on behalf of the company even if it pertains to challenge against the order of NCLT, in terms of the provisions of the Code. This may give rise to some practical concerns with respect to filing of appeals by the corporate debtor. This decision

of apex court to recognize the significance that insolvency and bankruptcy law plays a vital role in debt financing deserves appreciation in the interest of financial stress faced by corporate sector especially banking sector in India.

Legal validity of sections 8 and 9 of IBC

The apex court in *Macquarie Bank Limited* v. *Shilpi Cable Technologies Ltd.*[53] decided the question with regard to the legal validity of a notice sent by an advocate in the cases pertaining to IBC. Earlier, The NCLT interpreted the sections 8 and 9 of the IBC and held that section 8 of the IBC read with rule 5 of the Adjudicatory Authority Rules, 2016 mandate that only the 'Operational Creditor' or a person authorized to act on behalf of the 'Operational Creditor' can apply and therefore a lawyer's or a chartered accountants' or a company secretary's notice would not constitute a notice as per the requirement of the IBC.[54]

The Supreme Court reversed this position of NCLT and held that on the basis of interpretation of section 30 of the Advocates Act, the expression 'practise' is extremely wide and would include all preparatory steps leading to the filing of an application before a Tribunal. The court observed "the non-obstante clause contained in section 238 of the Code will not override the Advocates Act as there is no inconsistency between section 9, read with the Adjudicating Authority Rules and Forms referred to hereinabove, and the Advocates Act.[55] It also observed the role of an advocate to act on behalf of his client:[56]

> To insist upon the party himself personally signing the agreement or compromise would often cause undue delay, loss and inconvenience, especially in the case of non-resident persons. It has always been universally understood that a party can always act by his duly authorised representative. If a power-of-attorney holder can enter into an agreement or compromise on behalf of his principal, so can counsel, possessed of the requisite authorisation by vakalatnama, act on behalf of his client. Not to recognise such capacity is not only to cause much inconvenience and loss to the parties personally, but also to delay the progress of proceedings in court. If the legislature had intended to make such a fundamental change, even at the risk of delay, inconvenience and needless expenditure, it would have expressly so stated.

53 2017 SCC OnLine SC 1493: (2018) 2 SCC 674.

54 *Macquarie Bank Limited* v. *Uttam Galva Metallics Limited*, Company Appeal (AT) (Insol.) No.96 of 2017 (NCLAT).

55 *Supra* note 53, *id* at para 36.

56 *Id*. at para 39.

Effect of withdrawal after admission of application under IBC

The Supreme Court in *Lokhandwala Kataria Construction Private Limited* v. *Nisus Finance and Investment Managers LLP,*[57] considered whether NCLT could allow withdrawal of insolvency application after admission on the basis of the consent terms agreed between the parties. Rule 8 of Insolvency and Bankruptcy (Application to Adjudicating Authority Rules 2016) Rules allows the parties to withdraw the application prior to admission of the application by the NCLT which is the adjudicating authority under the Code. However, there is no provision for withdrawal of application after admission. The petitioner in this case approached NCLAT invoking its inerrant jurisdiction under Rule 11 of National Company Law Appellate Tribunal Rules, 2016 for withdrawal of the application on the basis of the consent term agreed between the parties. Rule 11 allows NCLAT to make orders for meeting the ends of justice. However, NCLAT refused to invoke its inherent power for this purpose. Hence, the petitioner challenged the order of the NCLAT before Supreme Court. The Supreme Court upheld the view of the NCLAT and held that NCLAT cannot invoke its inerrant power to allow the parties to withdraw the application after admission. However, Supreme Court invoked its own inerrant power under article 142 of the Constitution and allowed the parties to withdraw the application on the undertaking of the appellant to pay the outstanding dues to the applicant as per the consent terms.

Compliance of time period: its effect

The IBC prescribes a time bound process for handling insolvency applications. The sanctity of some of these time limits has been tested before the Supreme Court in *Surendra Trading Company* v. *Juggilal Kamlapat Jute Mills Company Ltd.*[58] The question before the Court was whether time limit of 7 days prescribed under the Code for rectifying or removing defects in the application filed by an operational creditor for initiating corporate insolvency resolution is mandatory or not. IBC section 9 deals with initiation of corporate insolvency resolution process by operational creditor. The section grants 14 days period to NCLT to accept or reject an application after the receipt of the application. However, before rejecting an application on the ground of any defects, NCLT has to give a notice to the applicant to rectify the defects and seven days period is given to the applicant to remove the defects. NCLAT was of the view that the time period of 14 days given to NCLT for accepting or rejecting an application is procedural in nature and cannot be treated to be a mandate of law. NCLAT further held that 14 days' time period is to be counted not from the date of filing an application but from the date when such an application is presented before the adjudicating authority, i.e. the date on which it is listed for admission/order. However, NCLAT straightly concluded that the time period of 7 days for rectifying the defect is mandatory and no specific rationale had been given for this conclusion.

57 Order in Civil Appeal No. 9279 of 2017, July 24, 2017.
58 2017 (11) SCALE 634.

Reversing this view of NCLAT, the Supreme Court held that it couldn't find any valid rationale in the conclusion of NCLAT that seven days' time period is mandatory. It further observed that NCLAT's conclusion cannot be justified on the ground of the time period of 180 days given in the Code for completion of the resolution process because the period of 180 days commences from the date of admission of application. Period prior to that, such as time consumed for scrutinizing the application, rectifying defects in the application or NCLT admitting the application etc. cannot be taken into account. In fact, till the objections are removed, it is not to be treated as application validly filed. It is only after the application is complete in every respect; it needs to be entertained. Under this scenario, the Court held that making the period of seven days as mandatory does not serve any purpose. The Court observed that in a given case there might be weighty, valid and justifiable reasons for not able to remove the defects within seven days. Accordingly, the provision of removing the defects within seven days is directory and not mandatory in nature. It also cautioned that while considering the application for extension of time, a balance approach need to be taken to avoid misuse of the provision. If the objections are not removed within seven days, the applicant while re-filing the application after removing the objections, file an application in writing showing sufficient cause as to why the applicant could not remove the objections within seven days. Once the NCLT is satisfied with the cause it can entertain the application or else it can reject the same.

Scope of definition of 'dispute' under IBC

The Supreme Court in a land mark judgment in *Mobilox Innovations Private Limited* v. *Kirusa Software Private Limited*,[59] clarified the interpretation of the term 'dispute' under the IBC as a dispute raised by the operational debtor prior to the issue of demand notice, even though no suit or arbitration is pending in respect of such dispute.

The IBC mandates that NCLT shall reject an application for corporate insolvency by an operation creditor, if the debtor has served a notice of dispute upon the operational creditor. Such notice of dispute shall bring to the notice of the operational creditor '*existence of a dispute*' or the fact that a suit or arbitration proceeding relating to a dispute is pending between the parties prior to the issue of demand notice by the operation creditor. The question before the Supreme Court was whether only a dispute pending before the court or arbitral tribunal could stop the insolvency proceedings or any other kind of dispute would qualify the criterion. After examining section 8 (6) of the IBC, the Court held that the interpretation of the term 'existence of dispute' includes dispute raised by the operational debtor prior to the issue of demand notice, even though no suit or arbitration is pending in respect of such dispute. Accordingly, an email sent by the debtor, raising dispute, prior to the issue of demand notice by the creditor, will also fall under the definition of dispute under the Code. NCLT only has

59 2017 (11) SCALE 754.

to examine, at the stage of admitting or rejecting an application, whether there is a plausible contention which requires further investigation and the 'dispute' raised by the operational debtor is not a patently feeble legal argument or an assertion of facts unsupported by evidence. However, while doing so, NCLT is not required to satisfy whether the dispute would ultimately succeed or not. So long as dispute truly exists in fact and is not spurious, hypothetical or illusory the NCLT has to reject the application.

The Supreme Court also examined definition of 'dispute' under section 5 (6) of IBC to consider whether dispute should fall under the three categories mentioned in the definition *viz* the existence of amount of debt; quality of goods or services; or breach of representation or warranty. The Court held that the definition is inclusive one as it only deals with suits or arbitration proceedings relating to any one of the three categories and not to any other kind of dispute. So long as there is a real dispute between the parties even though it does not fall under the above three categories, it would fall under the inclusive definition of dispute under section 5(6) of IBC. Hence, dispute raised by the debtor regarding breach of an NDA by the operational creditor in respect of the service provided, the operational creditor was held to be in a dispute within the meaning of the IBC.

VII INSURANCE

The Supreme Court in *Om Prakash* v. *Reliance General Insurance*[60] held that rejection of the claims purely on technical grounds in a mechanical manner will result in loss of confidence of policy holders in the insurance industry hence, insurance claims shall not be rejected on the technical grounds. If the reasons for delay in making a claim is satisfactorily explained, such a claim cannot be rejected on the ground of delay. Moreover, once such claims are already being verified and found correct by the investigating officers, it is not fair and reasonable to reject a genuine claim by stating technical lapses. In this case the insurance contract contained a clause "immediate information to the insurer about the loss/theft of the vehicle". The insured appellant in this case failed to comply when his truck insured with the insurance company got stolen. In another landmark decision of *National Insurance Co Ltd*. v. *Pranay Sethi*,[61] the apex court issued guidelines on fixation of future prospects for deciding motor accident claim. This decision is very remarkable in the field of insurance where the five judge bench unanimously agreed to consider the future prospects of the deceased victims of motor accident cases while determining of income for the purpose of computing the compensation claims of the victims. It observed "To follow the doctrine of actual income at the time of death and not to add any amount with regard to future prospects to the income for the purpose of determination of multiplicand would be unjust".[62] The court also stated that this concept needs to be applied equally to salaried

60 C.A.No.15611 of 2017 decided on Oct 4, 2017.
61 2017 SCC OnLine SC 1270 decided on Oct. 31, 2017.
62 *Id*. at para 53.

employees as well as self-employed persons. The reasoning given by the court is really appreciable especially when it explained that the purchasing capacity of a salaried person on permanent job increases because of grant of increments and pay revision or for some other change in service conditions, and there is always a competing attitude in the private sector to enhance the salary to get better efficiency from the employees. Similarly, a person who is self-employed is bound to garner his resources and raise his charges/fees so that he can live with same facilities. Regarding self-employed persons it was said "to have the perception that he is likely to remain static and his income to remain stagnant is contrary to the fundamental concept of human attitude which always intends to live with dynamism and move and change with the time".[63] The apex court also relied and recapitulated the decision of *Sarla Verma* v. *Delhi Transport Corporation,*[64] for determination of the multiplicand, the deduction for personal and living expenses, and the selection of multiplier.

These are some of the guidelines for computation of compensation laid down by the court:

(iii) While determining the income, an addition of 50% of actual salary to the income of the deceased towards future prospects, where the deceased had a permanent job and was below the age of 40 years, should be made. The addition should be 30%, if the age of the deceased was between 40 to 50 years. In case the deceased was between the age of 50 to 60 years, the addition should be 15%. Actual salary should be read as actual salary less tax.

(iv) In case the deceased was self-employed or on a fixed salary, an addition of 40% of the established income should be the warrant where the deceased was below the age of 40 years. An addition of 25% where the deceased was between the age of 40 to 50 years and 10% where the deceased was between the age of 50 to 60 years should be regarded as the necessary method of computation. The established income means the income minus the tax component.

(vii) The age of the deceased should be the basis for applying the multiplier.

(viii) Reasonable figures on conventional heads, namely, loss of estate, loss of consortium and funeral expenses should be Rs. 15,000/-, Rs. 40,000/- and Rs. 15,000/- respectively. The aforesaid amounts should be enhanced at the rate of 10% in every three years.

VIII CONCLUSION

This year, leading case analysis reflects the judicial dynamism towards growth of economy on the one hand and to protect the individual liberty on the other. It is a matter of concern that the lower judiciary lacks expertise to deal with the cases under

63 *Id*. at para 59.

64 (2009) 6 SCC 121.

SARFAESI Act and such cases reach the high court to get them rectified and revert back to the same court to decide on the basis of statutory principles. The powers of Magistrate under SARFAESI Act is only to provide necessary police force, if required, for the secured creditor and does not possess any adjudicatory authority. This emphasises the literal rule of interpretation as well as the need for minimum interference from the part of judiciary in the matters relating to recovery of loan of secured creditors especially banks and financial institutions in the interest of economic growth. The apex court rightly uphold the constitutionality of the IBC which is a beneficial legislation as far as secured creditors are concerned. Nonetheless, courts need to be more vigilant while deciding the cases under this since there are reckless borrowings and risky ventures without any concern for any accountability and in some cases the banking officials are also involved to assist the defaulters. Similarly, with regard to the money laundering cases, the dilution of bail provision and striking of twin principle of section 45A need further review in the interest of rise of fugitive offenders in this area as well as the peculiar nature of the crime involved. In the matter of insurance, the guidelines issued with regard to the compensation of victims of motor accident by the apex court shows their humanitarian approach towards the insured. It is a need in the coming years that judiciary requires more expert judges to decide the intricacies in the field of banking and insolvency laws for the smooth implementation of the legislations which aims for speedy disposal of litigations having negative impact on development of nation as a whole and corporate sector in particular.