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## UNDERSTANDING SARFAESI IN RESPECT OF SECURITY ENFORCEMENT

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### ABSTRACT

One of the important parameters to measure the growth of a nation is its economy and the growth in economy is well depends upon the functioning of the banking regulations. One of the key problems in the banking sector in India is the Non-Performing Assets. The Non-Performing Assets (NPAs) not only poses threats to bank but it also has a negative impact on the economy. That's why it become very important to recover loan without any unnecessary delay. Earlier banks had to face long delays from courts to recover loans. So, to cop up with these problems, Parliament passes 'The Recovery of Debts and Bankruptcy Act, 1993 (RDB Act) and establishes the Debt Recovery Tribunal to especially dealt with issues to recovery of loans from banks. Then in 2002 by the recommendation of Narsimham II committee, legislature passed the The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) to recover loan against the secured Assets.

In this research paper our aim is to discuss and understand the SARFAESI, the meaning of the key terms like NPAs, Reconstruction of Assets, Constitutional validity of the act and the key provisions of enforcement of security interest under SARFAESI and the borrowers rights.

### Introduction

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) is an act where in Banks are allowed to proceed against secured assets and banks can recover their nonpayment of loans without the intervention of court. The act empowers the banks to take possession of the secured assets without the intervention of court in case of default of payment by following the procedures laid down in this act. By the preamble of this Act, it can be said that the act not only deals with the Securitisation, Reconstruction of financial assets and enforcement of security interest but also gives a central database of security interest created on property rights. The act helps in minimizing the lengthy procedural delays in recovery of loans.

SARFAESI ACT was formed in Dec' 2002 based on recommendations of a) Committee on Banking Sector reforms (Narasimham Committee Report II) and b) Restructuring of Weak Public sector Banks (Verma Committee). This Act aims at

speedy recovery of defaulting loans and to reduce the mounting levels of Non-performing Assets of banks and financial institutions. The provisions of the Act enable the banks and financial institutions to realize long-term assets, manage problems of liquidity and asset liability disparities and to improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction. The Act provides three alternative methods for recovery of non-performing assets 1) Securitization 2) Asset Reconstruction 3) Enforcement of Security without intervention of the court<sup>1428</sup>

In this act, banks are equipped with Securitisations, Asset Reconstruction and Enforcement of Security interest to recover NPAs.

<sup>1428</sup> Mrs. Chandra Shaardha & Dr. Ajay Jain, The Impact of SARFAESI Act 2002 in recovering the Non Performance Assets in Public Sector Banks: A study on Recovery in SBI, CBI, CB, BOB and PNB (2008 to 2014), 11 IJAER 5218, 5219(2016)

### Understanding Key Terms

“non-performing asset” means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, 2 [doubtful or loss asset,— (a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;<sup>1429</sup>

An asset is classified as non-performing asset (NPA) if the borrower does not pay dues in the form of principal and interest for a period of 180 days. However, with effect from March 2004, default status would be given to a borrower if dues were not paid for 90 days. If any advance or credit facilities granted by a bank or the financial institution to a borrower become non-performing, then the bank have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact there may still exist certain advances/credit facilities having performing status..<sup>1430</sup>

“borrower” means 1 [any person who, or a pooled investment vehicle as defined in clause (da) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) which,] has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution 2 [and includes a person who, or a pooled investment vehicle which,] becomes borrower of a 3 [asset reconstruction company] consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such

financial assistance 4 [or who has raised funds through issue of debt securities]<sup>1431</sup>

In simple terms a borrower is someone who has been given financial assistance by a bank or financial institution, or who has created a mortgage, hypothecation, or pledge as security for that assistance.

“asset reconstruction” means acquisition by any 2 [asset reconstruction company] of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance.<sup>1432</sup>In simple terms Assets Reconstructions is a process in which ARC acquires the rights and interests of financial assistance given by banks or financial institutions for purpose of its realisations

**Assets Reconstructions company** - asset reconstruction company” means a company registered with Reserve Bank under section 3 for the purposes of carrying on the business of asset reconstruction or securitization, or both;<sup>1433</sup>

In layman language the function of Arc is to make agreement with banks so that it acquires financial assistance and then Arc will reconstruct assets by issuing debentures/ securities.

As per Sec 5. Assets Reconstructions Company may acquire financial interest by: -

- (i) making an agreement with banks to transfer financial assets
- (ii) By issuing debentures to banks as consideration as agreed upon between company and banks.
- (iii) In case if a bank is a lender in relation to financial assets, then ARC will be considered as lender as all the rights and interests shall vested in that company
- (iv) On acquisition of financial assets under sub-section (i), the 3[asset reconstruction

<sup>1429</sup>THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 2(o), No 54 Act of Parliament, 2002 (India).

<sup>1430</sup>Munish Gupta Dr. Rajni Saluja, EFFECTIVENESS OF SARFAESI ACT 2002 IN CONTROLLING NPAS OF PRIVATE SECTOR BANKS- AN EMPIRICAL STUDY, 5 IJRAR 73, 73 (2018)

<sup>1431</sup> THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 2(f), No 54 Act of Parliament, 2002 (India).

<sup>1432</sup> THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 2(b), No 54 Act of Parliament, 2002 (India).

<sup>1433</sup>THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 2(ba), No 54 Act of Parliament, 2002 (India).

company], may with the consent of the originator, file an application before the Debts Recovery Tribunal or the Appellate Tribunal or any court or other Authority for the purpose of substitution of its name in any pending suit, appeal or other proceedings and on receipt of such application, such Debts Recovery Tribunal or the Appellate Tribunal or court or Authority shall pass orders for the substitution of the 3[asset reconstruction company]in such pending suit, appeal or other proceedings<sup>1434</sup>

### **Constitutional Validity of SARFAESI Act**

The Constitutionality of the act was challenged as the plea was taken that some of the provision of the act was arbitrary in nature. In the case of *Mardia Chemicals v. Union of India*<sup>1435</sup> the Supreme court considered the Constitutionality of section 13 of the act. The Hon'ble Supreme Court of India held that the provisions of the SARFAESI Act 2002 are valid except subsection (2) of section 17, which is ultravires of Article 14 of the Constitution of India. However, court also held that any law which does not give the other party to represent a case would be violative of Article 14 of the Constitution.<sup>1436</sup> Hence section 13(3A) was inserted in the act by ordinance in 2004.

One of the major Impact of decision in *Mardia Chemical* case was that Section 3-A was inserted providing for an opportunity to the borrower to make a representation or raise objections against the demand notice issued under sub-section (2) of Section 13 and disposal of such representation within one week from the date of its receipt. A proviso was inserted that the reasons communicated to the borrower in response to the representation shall not confer any right upon him to prefer an application to the Debt Recovery Tribunal<sup>1437</sup>

### **Enforcement of Security Interest under SARFAESI**

SARFAESI empowers the banks to confiscate the property of the defaulting borrowers by issuing notice to the defaulters. Section 13 of the SARFAESI act deals with the regulations of the enforcement of security interests. Section 13(1) clearly states to give secured creditors the power to enforce security interests and recover dues from borrowers who default without court intervention.

As per sec. 13(2) of the said act, a prior notice has to be issued to the borrower to discharge his function within the period of sixty days. However, pursuant to the case of *Mardia Chemicals v. Union of India*<sup>1438</sup> sec. 13(3)A) was added which states If, on receipt of the notice under sub-section (2), the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate [within fifteen days]<sup>1439</sup>

After serving the 60 days' notice to the borrower, if borrower fails to repay the amount or comply to the instructions of the notice, the bank or financial institution may proceed to take charge of the secured assets of loan. In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely: –

- 1- take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
- 2- take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset:

<sup>1434</sup> THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 5(5), No 54 Act of Parliament, 2002 (India).

<sup>1435</sup> *Mardia Chemicals v. Union of India* (2004) 4 SCC 311

<sup>1436</sup> *Mardia Chemicals v. Union of India* (2004) 4 SCC 311

<sup>1437</sup> Amit M. Savadi, CRITICAL ANALYSIS OF JUDICIAL INTERPRETATION AS REGARDS CONSTITUTIONAL VALIDITY OF SARFAESI ACT 2002 2 WIJBAS 76 2017

<sup>1438</sup> *Mardia Chemicals v. Union of India* (2004) 4 SCC 311

<sup>1439</sup> THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 13(3)(A), No 54 Act of Parliament, 2002, (India).

Provided that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:

Provided further that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt;]

(c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;

(d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.<sup>1440</sup>

However, it is pertinent to note that if the borrower does not let authorized officer of the bank to get the possession of the property, then the only remedy secured creditor has been to make an application u/s 14 of the act to Chief Metropolitan Magistrate (CMM) or the District Magistrate (DM) to assist him in taking Possession of Secured Assets. Thus, sec.14 can be resorted to only when secured creditor has exhausted the option of sec.13(4)<sup>1441</sup> as it was stated in the case of M/s Transcore vs Union of India & Anr.<sup>1442</sup>

In relation to lessee/tenant, In Sri Jawahar Singh vs The United Bank Of India & Ors, 25/08/2014 Calcutta High Court held that if lessee/tenant resists the attempt of the secured creditor to take possession, the authorised officer cannot evict the lessee by force but has to file an application before the Chief Metropolitan Magistrate or the District Magistrate under Section 14 of the SARFAESI Act and state in the affidavit accompanying the

application, the name and address of the person claiming to be the lessee.<sup>1443</sup>

In respect of liability of Guarantor, the provision is mentioned in sec. 13(11) of the act. The secured creditor may also proceed against the guarantor without taking any measure as per sec 13(4). So, from my point of view, it can be stated that liability of guarantor is like of Principal Debtor. In the case of Standard Chartered Bank v. V. Noble Kumar<sup>1444</sup> the court stated that "Consequent upon the said decision, Parliament introduced sub-section 3[11] by Act 30 of 2004, which now provides for consideration of the objections, if any raised by the borrower. By definition under section 2(f) of the Act a borrower includes the guarantor of the debt"

Also, Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower<sup>1445</sup> In layman language if the debt owed by the borrower cannot be satisfied by the secured asset, then the secured creditor may submit an application to the Debt Recovery Tribunal. The Registrar of the Bench, whose jurisdiction the matter is within, may receive such an application from his authorized officer.

#### Remedies Available to The Borrower

The SARFAESI Act, 2002, equally protects the rights of the borrowers. The act allows borrowers to remit the dues before the sale of security assets takes place. In this way the borrowers can avoid losing their security assets. Additionally, the borrowers have the right of banking officials are found doing wrongful or illegal act that can lead to injustice towards

<sup>1440</sup> THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 13(4), No 54 Act of Parliament, 2002 (India).

<sup>1441</sup> Vijay Shekhar Jha, ENFORCEMENT OF SECURITY INTEREST UNDER SARFESI ACT" 4 IJAR 297 (2017)

<sup>1442</sup> M/s Transcore vs Union of India & Anr (2008) 1 SCC 125

<sup>1443</sup> Vijay Shekhar Jha, ENFORCEMENT OF SECURITY INTEREST UNDER SARFESI ACT 4 IJAR 299 (2017)

<sup>1444</sup> Standard Chartered Bank v. V. Noble Kumar, (2013) 9 SCC 620

<sup>1445</sup> THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002 13(10), No 54 Act of Parliament 2002 (India).

borrowers, they have go through the penal consequences.<sup>1446</sup>

As per sec 17 of the act, a borrower may file an application to the Debt Recovery Tribunal if he is aggrieved by the any action taken by the bank or financial institutions o his authorized representatives under sec 13(4) for recovery of secured assets within 45 days from the date on which action has been taken. However, HCs entertain such petitions on exceptional cases only. Such exceptional cases include instances when banks have not followed the procedures under the Act for taking possession of the mortgaged property or if the banks have accepted one-time settlement from the borrower which was agreed to be paid in a specified time and if the bank in the meantime files an application before the DRT.<sup>1447</sup>

In Trade Well vs Indian Bank<sup>1448</sup> Court stated that, “Remedy provided under Section 17 of the NPA Act is available to the borrower as well as the third party. Remedy provided under Section 17 is an efficacious alternative remedy available to the third party as well as to the borrower where all grievances can be raised. In view of the fact that efficacious alternative remedy is available to the borrower as well as to the third party, ordinarily, writ petition under Articles 226 and 227 of the Constitution of India should not be entertained. In exceptional cases of gravest injustice, a writ petition could be entertained by this Court. Great care and caution must be exercised while entertaining a writ petition because in a given case it may result in frustrating the object of the NPA Act”

### Conclusion

It can be noted that with the help of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, Indian banks are now able to significantly reduce their non-performing

assets (NPAs) by purchasing the security provided by the defaulting borrower against the loan and selling it to recoup losses without the need for legal intervention. Expanding the scope of the SARFAESI Act, 2002 is considered a crucial step in fortifying the nation's financial institutions, as it is an essential Act for the progress of the economy.

<sup>1446</sup> Nadeem Hasanmalek, THE SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT (SARFAESI),2002: A CRITICAL STUDY 11 RLJ 104 (2023)

<sup>1447</sup>S. Aravindan, Section 17 of SARFAESI: Is it effective for the borrowers?, PSA Legal Counsellors ( August 19, 2024, 10:38 AM),<https://www.psalegal.com/issue-xi-section-17-of-sarfesi-is-it-effective-for-the-borrowers/>

<sup>1448</sup> AIR 2007 (NOC) 1634 (BOM)