

CASE COMMENT:**VISHAL N. KALSARIA v. BANK OF INDIA AND OTHERS, AIR 2016 SC 530***Roopali Mohan****1. Introduction**

On January 20, 2016, a bench of the Supreme Court comprising Justice V. GopalaGowda and Justice Amitava Roy, pronounced a landmark judgment. According to this judgment, the non-obstante clause i.e. section 35 of SARFAESI Act, 2002 cannot be used 'to bulldoze the statutory rights vested on the tenants under the Rent Control Act.' The rights of the tenants were upheld but the adverse impact of this judgment on the Banks and Financial Institutes can also be anticipated.

Background

In India, after the liberalization of the economy and growth in various economic sectors, Banking Industry in particular was required to meet 'international prudential norms'. There remained absence of laws to deal with securitization of financial assets of banks and financial institutions. The existing legal frame work could not keep pace with the increase in the Non Performing Assets of the economy at large and the affected banks and financial institutions could not enforce securities on their own. They were bound to approach to the civil courts, which are already burdened with cases pending for more than a decade. The Central Government undertook the responsibility to deal with this situation and it constituted Narasimhan Committee I and II and Adhyarujina Committee to seek suggestions with respect to improvements and reforms in banking sector and amendments and additions to existing legal provisions.¹ On recommendations of Narasimhan Committee I, Recovery of Debts due to Banks and Financial Institutions Act, 1993 was enacted by the Parliament. This act endeavoured to reduce the burdens on city civil courts and established two forums i.e. Debt Recovery Tribunal and Debt Recovery Appellate Tribunal with the intention to adjudicated debt related matters as expeditiously as possible.² Owing to its drawbacks and series of litigation by banks, after the recommendations of Adhyarujina Committee, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (hereinafter referred as SARFAESI Act) was enacted by the Parliament

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¹ Statement of Object and Reasons, SARFAESI Act, 2002

² SARFAESI Act 2002, General Knowledge Today; available at: <http://www.gktoday.in/sarfaesi-act-2002/> (Visited on October 30, 2016)

with three pillars to enable the economy to overcome the menace of Non Performing Assets-

- (i) Securitisation
- (ii) Asset Reconstruction
- (iii) Enforcement of Securities without court's intervention

As a result, the Banks and Financial Institutions could now enforce securities of the loans given by them under Section 13 of SARFAESI Act without the intervention of courts and by serving a prior notice to the borrower, giving him 60 days time to repay the debt, failure of which would empower the banks to take over the security by virtue of Section 13(4).

Case Revisited

In this case, over ten appeals were decided by the Court as these appeals had the same question of law for court's consideration. For the sake of convenience, the Court referred to the facts of S.L.P.(CrI.) No.8060 of 2015. This appeal was filed against the impugned judgment of learned Chief Metropolitan Magistrate, Mumbai, who dismissed the application of the appellant for impleadment as an intervener.

In this case, Bank of India was approached by Respondent Nos. 4 and 5 for a loan, which the bank granted against equitable mortgage of several properties belonging to them. These properties included the property in which the appellant is allegedly a tenant. However, the respondent nos. 4 and 5 failed to repay the due amount within the stipulated time and their accounts were categorized as non performing assets under the provisions of SARFAESI Act. On 12.03.2010, Bank of India served a notice to them under Section 13(2) of SARFAESI Act. On failure of the respondents to repay the dues of loan within the statutory period of 60 days, Bank of India filed an application before the Chief Metropolitan Magistrate, Mumbai under Section 14 of the SARFAESI Act for seeking possession of the mortgaged properties which were in the possession of the Appellant. This application was allowed by the learned Chief Metropolitan Magistrate who directed the Assistant Registrar to take possession of the secured assets. The Appellant was asked to vacate the premises in which he was residing. Fearing the eviction, the Appellant filed a rent suit before the Court of Small Causes in Bombay which allowed the application and passed an ad interim order of injunction in favour of the Appellant. However, when the Appellant filed an application to stay the execution of the order passed by the Chief Metropolitan Magistrate, his application was dismissed by placing reliance on the case of *Harshad*

*Govardhan Sondagar v. International Assets Reconstruction Co. Ltd. & Ors.*³The Appellant filed the present appeal before the Hon'ble Supreme Court of India. The Supreme Court, after considering the submissions of the counsels for both the parties and perusing various judgments of this Court, set aside the orders passed by the High Court/Chief Metropolitan Magistrate and directed that the amounts in deposit pursuant to the conditional interim order towards rent either before the Chief Metropolitan Magistrate or with the concerned Banks shall be adjusted towards the debt due from the debtors/landlords by the concerned Banks. The Court also directed that the enhanced rent by way of conditional interim order shall be continued to be paid to the Banks and such amount shall be adjusted towards the debts of the debtors/landlords. It must also be noted that the Court also considered the interpretation of *Harshad Govardhan Sondagar* case wherein it was held, "the provisions of Section 13 of the SARFAESI Act override the provisions of Section 69 or Section 69A of the Transfer of Property Act, but does not override the provisions of the Transfer of Property Act relating to the rights of a lessee under a lease created before receipt of a notice under sub-Section (2) of Section 13 of the SARFAESI Act by a borrower."

Analysis Along With Foreseeable Upshots

Conflict of laudable objects of SARFAESI Act and Rent Control Act

The primary object of SARFAESI Act is 'to clothe the banks and financial institutions in India with power to take possession of securities and sell them.'⁴SARFAESI Act was enacted to facilitate securitization of financial assets of banks and financial institutions and to empower them to take possession of securities, sell or lease them or take them over after classifying them as Non-performing asset.⁵Non-performing assets (NPA) are a cost to the economy. When the Act was enacted in 2002, the NPA stood at Rs 1.10 lakh crores. This was a drag on the economy.⁶The continuous growth of such NPAs not only threatens the repayment capacity of the banks but they also have an adverse impact on the financial strength of the banks which are required to adhere to the International Standards of Banking in the present era of globalization.⁷

³ (2014) 6 SCC 1

⁴ *Pegasus Assets Reconstruction P. Ltd. v. M/s. Haryana Concast Limited & Anr.*, 2016 (1) SCALE 1

⁵ Section 2(1)(o) defines Non-performing asset as an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, 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;

(b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank

⁶ *Transcore v. Union of India & Anr.*, (2008) 1 SCC 125

⁷ *ICICI Bank Ltd. v. Official Liquidator of APS Star Industries Ltd.*, (2010) 10 SCC 1

On the other hand, Rent Control Acts were enacted to secure the rights of the tenants. Historically, these Rent Control Acts can be traced back to Second World War when the cost of living had increased and tenants were at the mercy of the landlords in the matters of eviction and prices of rent.⁸ These social legislations are provincial in nature and differ from State to State.⁹

In the instant case, the Supreme Court observed that the SARFAESI Act and the Rent Control Act operate in completely different fields and held that the provisions of the SARFAESI Act cannot override the provisions of the Rent Control Act, otherwise SARFAESI would render all the Rent Control Legislations as useless and nugatory. The tenants would dread that the landlord may use the tenanted premises as a security interest for a bank loan and subsequently default on it. In case of default, tenants would be affected who would be evicted from the tenanted property by the bank under the provisions of the SARFAESI Act which cannot be permitted in the light of the statutory protections to the tenants under the Rent Control Act.

The Supreme Court did recognize the fact that the tenants maybe put to peril due to the default of the landlord in repayment of Bank loan but seems to have overlooked the existing state of NPAs as a huge burden on the economy. The current Finance Minister of India, Mr. Arun Jaitley opined, “India has to learn to be a mature democracy in its responses. And, therefore, when you have a sectoral slowdown which has impacted the health of banks, we must learn how to respond. The response has to be to empower the banks, to recapitalise the banks. And allow the banks freedom to take decisions on banking considerations... There is an unfair pressure on executives of bank who could otherwise enter into bona fide settlements based on banking considerations- the relationship between lender and creditor. The NPA issue goes far beyond one delinquent defaulter.”¹⁰

In *Mardia Chemicals Ltd. and Others v. Union of India and Others*,¹¹ while discussing the characteristics of a private contract, the Supreme Court observed that a transaction which as a whole has far-reaching effect on the economy of the country cannot be ignored and it cannot be restricted to individuals particularly when it relates to financing through banks and financial institutions which utilize the money for people in

⁸Vishal N. Kalsaria Case, ¶ 22

⁹ Introduction, The Delhi Rent Control Act, 1958

¹⁰ Deepshikha Sikarwar and Vinay Pandey, “If legitimate money comes in, it increases size of economy: FM Arun Jaitley”, The Economics Times, May 25, 2016 available at <http://economictimes.indiatimes.com/opinion/interviews/if-legitimate-money-comes-in-it-increases-size-of-economy-fm-arun-jaitley/articleshow/52424894.cms> (Visited on October 30, 2016)

¹¹ (2004) 4 SCC 311

general. It was very rightly observed by the Court that individual rights may be unable to withstand a force wherever they conflict with public interest which becomes necessary to be achieved. Thus, interest of an individual may be affected to certain extent but it cannot be said to have the potential of taking over public interest which has an impact on the socio-economic drive of the country. The constitutional validity of SARFAESI Act was upheld in this case.

The judgment is a boon to the unscrupulous borrowers/landlords

It cannot be denied that the Banking sector in India is facing a huge number of defaulters of bank loans. The probability of letting out the secured premises by the unscrupulous landlords in order to prevent the enforcement of the security by the banks cannot be ruled out. As an illustration, a person A seeks to raise loan from a Bank and accordingly mortgages a premises. Subsequently anticipating his inability to repay the debt, he lets out the mortgaged premises with the intention to prevent the bank from enforcing the security interest. Now in the light of this judgment, on default of the landlord, the tenant cannot be evicted and the banks, who were already bearing losses on account of innumerable NPAs are unable to take a recourse to the remedy as envisaged under SARFAESI Act. Practically, the amount of rent, if adjusted towards the liability outstanding against the borrower/landlord, does not do any justice to the bank as this rent in most of the cases is not sufficient to repay the accrued monthly interest leave aside the total liability.

The decision is incomplete as to the duration of the lease

Ultimately, the Court directed that the amounts which are in deposit towards rent either before the Chief Metropolitan Magistrate or with the concerned Banks shall be adjusted by the concerned Banks towards the debt due from the debtors/landlords. The Court further directed that the enhanced rent by way of conditional interim order shall also be continued to be paid to the respective Banks and such amount shall also be adjusted towards debts of the debtors/landlords. The questions here arise is that what is the duration of time period in which these directions are to be carried out? Secondly, on the termination of the lease, would renewal of the lease be allowed or the Banks would be allowed to carry out enforcement of the Security Interest? Here, the Court did not specify the time period during which the above mentioned directions are to be carried out. As far as the second question is concerned, a conflict of interest cannot be denied.

Suggestive Proposition

The controversies which are bound to occur after the pronouncement of this landmark judgment may be done away with the following suggestions:

- (i) Any debtor who lets out the property after mortgaging it with the Bank without obtaining prior permission from the lending institution shall be punished with a heavy penalty and/or with imprisonment if the circumstances justify.
- (ii) On termination of the lease subsequent to the action brought by the Bank under section 13 of SARFAESI Act 2002, renewal shall not be allowed and the Banks shall be allowed to proceed against the debtor/landlord by enforcing the security interest.

2. Conclusion

In the light of the above stated analysis, it can be concluded that though the Supreme Court tried to protect the tenants from eviction, it failed to appreciate the consequences of this judgment as the Banks lend out the money which belongs to the Public at large. It must not be forgotten that if the provisions of SARFAESI Act are not given effect in an apprehension that the Rent Control legislations would be rendered useless, the Courts must also realize that the very object of SARFAESI Act enacted by the Parliament would fail which was enacted to ensure that there are no unwarranted impediments in the recovery of debts. This short sighted judgment will have a cascading effect as majority of intending defaulters would now take a refuge under this judgment.