"Sarfaesi act, sica act, interplay between them and the overriding effect of sarfaesi over sica"

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Abstract

This article touches upon the legislative intent and working of Sarfaesi and Sica act. It covers the interplay between Sarfaesi and Sica Act. Ever since Sarfaesi Act has come into force, the most intriguing aspect of the said act has been its interplay with the Sica act. For every defaulting borrower, the argument of overlapping between Sarfaesi and Sica is most favourable of all. It has been contended in so many cases before courts that for a secured creditor to proceed under Sarfaesi under section 13(4), a reference under section 15 of Sica act must be pending before the BIFR In other words, Banks and financial Institutions cannot proceed under Sarfaesi unless a reference exist before the Board. This argument is completely oblivion of the fact, that secured creditors can proceed under section 13(4) notwithstanding a reference not pending before BIFR, if they comply with the condition as laid in section 13(9) of Sarfaesi act .However, with the judgment of the court in M/S .Global Infrastructure Vs .Kotak Mahindra Bank Ltd & Ors and Madras Petrochemicals vs. BIFR, it has been made clear that, Sarfaesi and sica have distinct are of operation and hence they do not overlap. Lastly, the article covers Sarfaesi victory over Sica. As pronounced in Madras Petrochemicals vs. BIFR, that in case of inconsistency between Sarfaesi and sica, the former would prevail in light of section 32 of the Act. The madras petrochemicals judgment has ushered in such time, when the effect of Non-performing Assets and dodgy loans were having far-reaching effect on our economy. With this judgment, we hope a better sense would prevail over the borrowers.

The most conventional argument on behalf of every defaulting borrower whose dodgy loans and Non-performing Assets(NPA)[1] cause perennial pains and problem to secure creditors and society at large , is while a reference is pending before Board of Industrial and Financial Reconstruction(BIFR) , the Banks and Financial Institutions cannot proceed under

[1] 2(o) of Sarfaesi ; non-performing asset means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or under guidelines relating to assets classifications issued by the Reserve Bank;

Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Sarfaesi Act) act in view of the bar contained under section 22[2] of the Sick Industrial Companies (Special Provisions) Act, 1985 (Sica). However, with the latest Judgment of Hon'ble Supreme Court ***MADRAS PETROCHEMICALS VS BIFR***[3], the borrowers have received a serious blow and left all of them frustated.At the same time, all the Banks and Financial Institutions welcomed the judgment and views it as logical and much-needed decision.

Dealing with Sick Industrial Companies (Special Provisions) Act first, in the backdrop of a large number of industrial companies facing industrial sickness, a need was felt to enact, in public interest, a legislation to provide for timely determination, by a body of experts, of the preventive, ameliorative, remedial and other measures that would be needed to be adopted

[2] 22. Suspension of legal proceedings, contracts, etc- (1) Where in respect of an industrial company, an inquiry under section 16 is pending or any scheme referred to under section 17 is under preparation or consideration or a sanctioned scheme is under implementation or where an appeal under section 25 relating to an industrial company is pending, then, notwithstanding, anything contained in the Companies Act, 1956 (1 of 1956) or any other law or the memorandum and articles of association of the industrial company or any other instrument having effect under the said Act or other law, no proceedings for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company or for the appointment of a receiver in respect thereof 2[and no suit for the recovery of money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans or advance granted to the industrial company] shall lie or be proceeded with further, except with the consent of the Board or, as the case may be, the Appellate Authority. (2) Where the management of the sick industrial company is taken over or changed 3[in pursuance of any scheme sanctioned under section 18] notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), or any other law or in the memorandum and articles of association of such company or any instrument having effect under the said Act or other law) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company; b) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the Board. (3) 4[where an inquiry under section 16 is pending or any scheme referred to 1for "During the period" (w.e.f. 01.02.1994) in section 17 is under preparation or during the period] of consideration of any scheme under section 18 or where any such scheme is sanctioned there under, for due implementation o f the scheme, the Board may by order declare with respect to the sick industrial company concerned that the operation of all or any of the contracts, assurance of property, agreements, settlements, awards, standing orders or other instruments in force, to which such sick industrial company is a party or which may be applicable to such sick industrial company immediately before the date of such order, shall remain suspended or that all or any of the rights, privileges, obligations and liabilities accruing or arising there under before the said date, shall remain suspended or shall be enforceable with such adoptions and in such manner as may be specified by the Board. Provided that such declaration shall not be made for a period exceeding two years which may be extended by one year, at a time so, however, that the total period shall not exceed seven years in the aggregate. (4) Any declaration made under sub-section (3) with respect to a sick industrial company shall have effect notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), or any other law, the memorandum and articles of association of the company or any instrument having effect under the said Act, or other law or any agreement or any decree or order of a court, tribunal, officer or other authority or of any submission, settlement or standing order and accordingly,- (a) any remedy for the enforcement of any right, privilege, obligation and liability suspended or modified by such declaration, and all proceedings relating thereto pending before any court, tribunal, officer or other authority shall remain stayed or be continued subject to such declaration; and (b) on the declaration ceasing to have effect- (i) any right, privilege, obligation or liability so remaining suspended or modified shall become revived and enforceable as if the declaration had never been made; and (ii) any proceeding so remaining stayed shall be proceeded with, subject to the provisions of any law which may then be in force, from the stage which had been reached when the proceedings became stayed. (5) In computing the period of limitation for the enforcement of any right, privilege, obligation or liability, the period during which it or the remedy for the enforcement thereof remains suspended under this section shall be excluded.

[3] (2016) 4 SCC 1

with respect to such companies and for enforcement of the appropriate measures with utmost practicable despatch. . Thus, the Sick Industrial Companies (Special Provisions) Act, 1985 (Sica), came into being in 1985.

Legislative scheme of the sica, 1985

The Sick Industrial Companies (Special Provisions) Act, 1985 (Sica), was a key piece of legislation dealing with the issue of rampant industrial sickness in India. The Sick Industrial Companies (Special Provisions) Act (Sica) of 1985 was enacted in India to determine the extent of sickness in industrial units, expedite the revival of potentially viable companies and close unviable units to release investment locked up in them for productive use elsewhere. The architect of law felt that existing institutional arrangements and procedure for revival and rehabilitation of potentially viable sick industrial companies are both inadequate and time consuming. Multiplicity of law and the regulatory agencies makes the adoption of a coordinated approach for dealing with sick industrial companies difficult. The adverse effects of the sickness in the industrial production such as cessation of production, loss of employment, loss of revenue to the Central government are of serious concern to the society at large and have far-reaching effect on economy of our country.. The statement of Object and Reasons of the Act categorically specifies the motive behind the act is to revamp the sick industries, to fully utilize the productive industrial assets and funds of banks and financial institutions. Hence, to check in the sickness of an industry, the BIFR was established, consisting of experts in various relevant fields with powers to enquire into and determine the incidence of sickness in industrial companies and devise suitable remedial measure through appropriate schemes or other proposals and for proper implementation thereof.

Overview of working of sica act

A perfunctory reading of the act shows that a Board for Industrial and Financial Reconstruction (BIFR) is set up by the act, before which references are made. References can be made under section 15[4] of the act not only by the industrial company[5] , but also by the

[4] Reference to Board.- (1) When an industrial company has become a sick industrial company, the Board of Directors of the company, shall, within sixty days from the date of finalisation of the duly audited accounts of the company for the financial year as at the end of which the company has become a sick industrial company, make a reference to the Board for determination of the measures which shall be adopted with respect to the company

Provided that if the Board of Directors had sufficient reasons even before such finalisation to form the opinion that the company had become a sick industrial company, the Board of directors shall, within sixty days after it has formed such opinion, make a reference to the Board for the determination of the measures which shall be adopted with respect to the company:

1[Provided further that no reference shall be made to the Board for Industrial and Financial Reconstruction after the commencement* of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, where financial assets have been acquired by any securitisation company or reconstruction company under sub-section (1) of section 5 of that Act:

Provided also that on or after the commencement* of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, where a reference is pending before the Board for Industrial and Financial Reconstruction, such reference shall abate if the secured creditors, representing not less than three-fourth in value of the amount outstanding against financial assistance disbursed to the borrower of such secured creditors, have taken any measures to recover their secured debt under sub-section (4) of section 13 of that Act.)

Central or State government, or Public Institutions, or State Level Institutions, or a Scheduled Bank, as the case may be. Sica applies to companies both in public and private sectors owning industrial undertakings:-

a) Pertaining to industries specified in the first schedule to the Industries(Development and Regulation) Act, 1951 , except the industries relating to ships and other vessels drawn by power and;
b) Not being small scale industrial undertakings or ancillary undertakings, as defined in section 3(j) of the IDR Act;
c) The criteria to determine sickness in an industrial company are: (1) The accumulated losses of the company be equal to or more than its net worth i.e. paid up capital plus free reserves, (2) The company should have completed five years after incorporation under the Companies Act, 1956, (3) It should have 50 or more workers on any day of the 12 months preceding the end of the financial year with reference to which sickness is claimed, (4) It should have a factory license. Thus, three requisite for a company to make a reference before board are;

- The company is one which is mentioned in the first schedule to the Industries (Development and Regulation) Act, 1951;
- A company is registered for not less than 5 years and ;
- A company has become sick[6] meaning thereby it has at the end of financial year accumulated losses equal to or exceeding its entire net worth.

After the reference has been made under section 15 of the act, an inquiry under 16 of the act would take place. An inquiry can be made by the BIFR on receipt of a reference or upon information or suo motu. After a thorough inquiry under section 16 of the act is conducted, section 17 comes into play. Role of section 17[7] is very clearly specified in ***MADRAS***

(2) Without prejudice to the provisions of sub-section (1), the Central Government or the Reserve Bank or a State Government or a public financial institution or a State level institution or a scheduled bank may, if it has sufficient reasons to believe that any industrial company has become, for the purposes of this Act, a sick industrial company, make a reference in respect of such company to the Board for determination of the measures which may be adopted with respect to such company: Provided that a reference shall not be made under this sub-section in respect of any industrial company by- (a) The Government of any State unless all or any of the industrial undertakings belonging to such company are situated in such State;
(b) A public financial institution or a State level institution or a scheduled bank unless it has, by reason of any financial assistance or obligation rendered by it, or undertaken by it, with respect to, such company, an interest in such company.

[5] [e] "industrial company" means a company which owns one or more industrial undertakings;
[f] "industrial undertaking" means any undertaking pertaining to a scheduled industry carried on in one or more factories by any company but does not include- (i) an ancillary industrial undertaking as defined in clause(aa) of section 3 of the Industries (Development and Regulation) Act, 1951 (65 of 1951); and [ii] a small scale industrial undertaking as defined in clause (j) of the aforesaid section 3;

4. [o] "Sick industrial company" means an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth. Explanation- For the removal of doubts, it is hereby declared that an industrial company existing immediately before the commencement* of the Sick Industrial Companies (Special Provisions) Amendment Act, 1993, registered for not less than five years and having at the end of any financial year accumulated losses equal to or exceeding its entire net worth, shall be deemed to be a sick industrial company;]

[7]17. Powers of Board to make suitable order on the completion of inquiry. – (1) If after making an inquiry under section 16, the Board is satisfied that a company has become a sick industrial company, the Board shall, after

Petrochemicals vs Bifr. It was observed ***"If*** the Board is satisfied that the Company has indeed become a sick industrial company, the Board shall decide as to whether it is practicable for the Company to make its net worth positive within a reasonable time. This it may do under Section 17 of the Act, by order under sub-section (2) of Section 17. If this is not possible, then the Board may appoint an Operating Agency who will prepare scheme for rehabilitation mentioned in Section 18 which the Board may then sanction. The scheme may provide for all or any of the things mentioned in the said Section, and finally, the scheme may work successfully, resulting in the Company's net worth turning positive, or may be unsuccessful. In the event of it being unsuccessful, the Board may modify such scheme or ask for the preparation of a new scheme. If, at the end of the day, the first scheme or any successive schemes ultimately fail, the Board has then to be of the opinion that such Company is not likely to make its net worth positive, and that therefore it is to forward its opinion under Section 20 of the Act to the concerned High Court to proceed with the winding up of the said company."[8]

Thus, a sick industry would wound up if BIFR after conducting an inquiry under section 16 of the act, forms an opinion under section 17 of the act that company's net worth is not likely to exceed its accumulated losses, and also various schemed formed by operating agency to help overcome the sickness of industries fails, then the High court will on the basis of opinion formed by BIFR, may order winding up of the company under section 20[9] of the Act.

considering all the relevant facts and circumstances of the case, decide, as soon as may be by order in writing, whether it is practicable for the company to 2(make its net worth exceed the accumulated losses) within a reasonable time. (2) If the Board decides under sub-section (1) that it is practicable for a sick industrial company to 2(make its net worth exceed the accumulated losses) within a reasonable time, the Board, shall, by order in writing and subject to such restrictions or condition as may be specified in the order, give such company as it may deem fit to 2(make its net worth exceed the accumulated losses.) (3) If the Board decides under sub-section(1) that it is not practicable for a sick industrial company to 1(make its net worth exceed the accumulated losses) within a reasonable time and that it is necessary or expedient in the public interest to adopt all or any of the measures specified in section 18 in relation to the said company it may, as soon as may be, by order in writing, direct any operating agency specified in the order to prepare, having regard to such guidelines as may be specified in the order, a scheme providing for such measures in relation to such company. (4) The Board may. - (a) If any of the restrictions or conditions specified in an order made under sub-section (2) are not complied with by the company concerned, 3(or if the company fails to revive in pursuance of the said order,) review such order on a reference in that behalf from any agency referred to in sub-section (2) of section 15 or on its own motion and pass a fresh order in respect of such company under sub-section (3); (b) If the operating agency specified in an order made under sub-section (3) makes submission in that behalf, review such order and modify the order in such manner as it may deem appropriate.

[8] Madras Petrochemical Vs Bifr, Para No [15]

[9] Winding up of sick industrial company- 1[(1) Where the Board after making inquiry under section 16 and after consideration of all the relevant facts and circumstances and after giving an opportunity of being heard to all concerned parties, is of opinion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time while meeting all its financial obligations and that the company as a result thereof is not likely to become viable in future and that it is just and equitable that the company should be wound up, it may record and forward its opinion to the concerned High Court.] (2) The High Court shall, on the basis of the opinion of the Board, order winding up of the sick industrial company and may proceed and cause to proceed with the winding up of the sick industrial company in accordance with the provisions of the Companies act, 1956 (1 of 1956), (3) For the purpose of winding up of the sick industrial company, the High Court may appoint any officer of the operating agency, if the operating agency gives its consent as the liquidator of the sick industrial company and the officer so appointed shall for the purposes of the winding up of the sick industrial company be deemed to be, and have all the powers of, the official liquidator under the Companies

Conclusively, the role of Sica act is to determine sickness in the Industrial Companies and to aid in reviving viable units and shutting down others.

Coming to Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, it rolled in 2002 and allows secured creditors to sell off or auction mortgaged property in case of default on part of borrower in repayment of loan and when his assets have been declared as Non-performing Asset (NPA).The act at a time when Sica Act had become haven for promoters of defaulting and sick industries to avoid repayment of instalments and loans. The dilly-dally approach offered by Sica by way of BIFR route to every debt-dodger prevented secured creditors from taking legal action .Thus, presence of Sarfaesi was a well-needed one.

Legislative scheme of the sarfaesi act

It was a need of an hour to bring about such a legislature which would give stringent power to secured creditors to sell off the assets of the borrower in case of default in repayment of loan or any instalment and his account being declared as non-performing assets, without the intervention of courts. Thus, Narasimham Committee I and II and Andhyarujina Committee constituted by the Central Government for the purpose of examining banking sector reforms considered the need for changes in the legal system in respect of these areas. These Committees, inter alia, have suggested enactment of a new legislation for securitisation and empowering Banks and financial Institutions to take possession of the securities and to sell them without the intervention of the court. Acting on these suggestions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002 was promulgated on the 21st June, 2002 to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The provisions of the Ordinance would enable Banks and Financial Institutions to realise long-term assets, manage problem of liquidity, asset liability mismatches and improve recovery by exercising powers to take possession of securities, sell them and reduce nonperforming assets by adopting measures for recovery or reconstruction. The act aimed to provide , interalia, a) for registration and regulation of securitisation companies or reconstruction companies by the Reserve Bank Of India; b)defining ' security interest' as any type of security including mortgage and charge on immovable properties given for due repayment of any financial assistance given by any bank or financial institution; and c) empowering Banks and Financial Institutions to take possession of securities given for financial assistance and sell or lease the same or take over management in the event of default, i.e. classification of the borrower's account as Non-performing Asset in accordance with the directions given or under guidelines issued by the Reserve Bank of India from time to time.

Act, 1956 (1 of 1956). (4) Notwithstanding anything contained in sub-section (2) or sub-section (3), the Board may cause to be sold the assets of the sick industrial company in such manner as it may deem fit and forward the sale proceeds to High Court for orders for distribution in accordance with the provisions of section 529A, and other provisions of the companies Act, 1956 (1 of 1956).

Overview of working of sarfaesi act

To recover money from the borrower is the prime motive of this act and in order to facilitate the same, certain sections have been imbedded in the Act. To begin with, section 13, deals with enforcement of security interest, is the most crucial provision of the act. In order to recover money from the borrower, the secured creditor i.e. Banks and Financial Institutions, is required to send a notice to the borrower under section 13(2)[10] , stating clearly the amount outstanding and require him to pay the liabilities within 60 days from the date of notice, failing which, the secured creditor shall be entitled to exercise all or any of the rights specified in section 13(4)[11]. Section 13(3) of the Act provides that the notice under Section 13(2) of the Act shall give details of the amount payable by the borrower as also the details of the secured assets intended to be enforced by the bank. Section 13(3-A)[12] of the Act was inserted by Act 30 of 2004 after the decision of this Court in ***MARDIA CHEMICALS LTD VS. UNION OF INDIA***[13], and provides for a last opportunity for the borrower to make a representation to the secured creditor against the classification of his account as a Non-performing Asset. The secured creditor is required to consider the representation of the borrowers, and if the secured creditor comes to the conclusion that the representation is not tenable or acceptable, then he must communicate, within one week of the receipt of the communication by the borrower, the reasons for rejecting the same. Section 13(4) of the Act provides that if the borrower fails to discharge his liability within the period specified in Section 13(2), then the secured creditor, may take recourse to any of the actions mentioned in the provision, to recover his debt.

The acts distinctly list down under section 13(4) various measures available to secured creditors to recover his debt. Thus, a secured creditor can recover his debt by way of lease, assignment or sale of secured interest. Thus, a secured creditor can take possession of the secured assets of the borrower including right to transfer by way of lease, assignment or sale for realising the secured assets without any intervention of courts. This transfer of power

[10] 13 (2): Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4).

[11] In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:-a. Take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset; b. Take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realize the secured assets. 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 creditors. 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..

[12] (3A) 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 one week of receipt of such representation or objection the reasons for no acceptance of the representation or objection to the borrower: Provided that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A.]

[13] Mardia Chemicals Vs Union Of India, SLP (C) No. 15566 Of 2003

from the hands of courts to Banks and Financial Institution to realise there dodgy loans is an exceptional and one of a kind power handled down to Banks and Financial Institutions only. However, the banks and financial institutions cannot directly exercise their power under section 13(4) without giving borrower a 60 days' notice under section 13(2). Therefore, the Banks and financial Institutions must give 60 days' notice to the borrower to discharge there liabilities. If still, they don't discharge their liabilities, banks can take recourse to section 13 (4) of the act. Thus section 13 (2) is a compulsory requisite for the secured creditors to exercise power under section 13(4).

Section 14[14] of the Act provides that the secured creditor can file an application before the Chief Metropolitan Magistrate or the District Magistrate, within whose jurisdiction, the secured asset or other documents relating thereto are found for taking possession thereof. If any such request is made, the Chief Metropolitan Magistrate or the District Magistrate, as the case may be, is obliged to take possession of such asset or document and forward the same to the secured creditor. Therefore, it follows that a secured creditor may, in order to enforce his rights under Section 13(4), in particular Section 13(4) (a), may take recourse to Section 14 of the Act.

However, to prevent misuse of wide powers and prevent arbitrary and unreasonableness on part of Banks, checks and balances under section 17[15] was introduced. As noted in ***Authorised Officer, Indian Overseas Bank & Anr. Vs. Ashok Saw Mill***[16]**,** section 17 keeps a check on wide powers of secured creditors, which allow any person including borrower, aggrieved by action taken under section 13(4) by secured creditor, to make an application to the Debt Recovery Tribunal having jurisdiction in the matter within 45 days from the date of such measures having taken for the reliefs indicated in sub-section (3) thereof. Action taken

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[14] **14. Chief Metropolitan Magistrate or District Magistrate to assist secured creditor in taking possession of secured asset.-1.** Where the possession of any secured asset is required to be taken by the secured creditor or if any of the secured asset is required to be sold or transferred by the secured creditor under the provisions of this Act, the secured creditor may, for the purpose of taking possession or control of any such secured asset, request, in writing, the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction any such secured asset or other documents relating thereto may be situated or found, to take possession thereof, and the Chief Metropolitan Magistrate or, as the case may be, the District Magistrate shall, on such request being made to him-a. Take possession of such asset and documents relating thereto; and b. Forward such asset and documents to the secured creditor. 2. For the purpose of securing compliance with the provisions of sub-section (1), the Chief Metropolitan Magistrate or the District Magistrate may take or cause to be taken such steps and use, or cause to be used, such force, as May, in his opinion, is necessary 3. No act of the Chief Metropolitan Magistrate or the District Magistrate done in pursuance of this section shall be called in question in any court or before any authority

[15] **17. Right to appeal.-1.** Any person (including borrower), aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorized officer under this Chapter, may prefer an appeal to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken. 2. Where an appeal is preferred by a borrower, such appeal shall not be entertained by the Debts Recovery Tribunal unless the borrower has deposited with the Debts Recovery Tribunal seventy-five per cent. Of the amount claimed in the notice referred to in sub-section (2) of section 13 Provided that the Debts Recovery Tribunal may, for reasons to be recorded in writing, waive or reduce the amount to be deposited under this section. 3 Save as otherwise provided in this Act, the Debts Recovery Tribunal shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) and rules made there under.

[16] Civil Appeal No.4429 OF 2009

by a secured creditor in terms of section 13(4) is open to scrutiny and cannot only be set aside but even the status quo ante can be restored by the Debt Recovery Tribunal.

Thus, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, has not given unwarranted powers to secured creditor under section 13 of the Act. The systems of proper check and balances have been imbedded in the act by way of section 17 of the act. But, despite that section 17 is viewed as 'toothless', since it allows appeal only after the measure under section 13(4) have been taken. In other words, section 17 does not offer pre-action remedy. That being said, Sarfaesi is an extremely significant legislation to recover money from the hands of borrowers.

Interplay between sarfaesi act, 2002 and sica act, 1985

Ever since Sarfaesi Act has come into force, the most intriguing aspect of the said act has been its interplay with the Sica act. For every defaulting borrower, the argument of overlapping between Sarfaesi and Sica is most favourable of all. It has been contended in so many cases before courts that for a secured creditor to proceed under Sarfaesi under section 13(4), a reference under section 15 of Sica act must be pending before the BIFR In other words, Banks and financial Institutions cannot proceed under Sarfaesi unless a reference before the Board exists. This argument is completely oblivion of the fact that secured creditors can proceed under section 13(4), notwithstanding, a reference not pending before BIFR if they comply with the condition as laid down in section 13(9) of the Sarfaesi act.

The similar argument was taken in ***Noble Aqua Pvt Ltd Vs .State Bank of India***[17] case, the borrower company filed an application under section 15 (1) of Sica in October 2005. Initially, BIFR refused to register the reference, but on appeal to the AAIFR, the reference was directed to be registered. In November 2006, BIFR overruled the objections of the Bank and declared the Company to be a Sick Unit. Eventually the bank filed a possession notice under section 13(4) of the securtisation act. However it was contended on behalf of the borrower, firstly, In view of section 22 of Sica Act, there exist bar against any proceedings under any laws. Secondly, as result of third proviso added to section 15 of Sica by amendment in section 41 of the Sarfaesi act, reference would abate if the secured creditors representing not less than $3/4^{th}$ in value of the amount outstanding against financial assistance disbursed to the borrower of such secured creditors, have taken any measures to recover their debt under sub-section (4) of section 13 of that act. It was argued on behalf of the borrower, that since the borrower company has been declared as sick company, therefore reference no longer exists. Consequently section 13(4) cannot be exercised since reference under section 15 no longer exists. In order words, the Banks and FIs can proceed under Sarfaesi act only when a reference under section 15 exists. Once an industry is declared as sick unit, the reference ceases to exist.

[17] AIR 2008 Ori103

However, in ***M/s. Salem Textiles Ltd Vs. The Authorized Officer***[18] case, the scope of reference has been made clear by the Hon'ble High Court, "In our considered opinion, the proceeding before BIFR continues to be a reference, either till rehabilitation takes place and the company is revived or till an opinion is rendered by BIFR to the High Court recommending winding up. If this is so, then there is no difficulty in concluding that the expression "reference" found in the third proviso to section 15 (1) of SICA would encompass within itself, the whole gamut of proceedings including enquiry under section 16, passing of orders under section 17, preparation and sanctioning of schemes under section 18, rehabilitation through financial assistance under section 19 and the recommendation for winding up under section 20."[19] Thus, the position is clear that reference under section 15 not only includes not only a reference made to the Board under section 15 , but also inquiry under section 16 conducted on the basis of reference under section 15 , working of scheme under section 17 and winding up order under section 20 of the act. That being so, until the rehabilitation takes place of sick industries, reference before the BIFR exist.

Thus, since the Noble Aqua case has been decided there exist conflict of interplay between these two acts. Few high courts believed in that Sica and Sarfaesi overlap with each other, and the others believe they don't overlap and have distinct field of operation. And this uncertainty and unambiguity has been made clear by Madras High Court in ***M/S .Global Infrastructure Vs .Kotak Mahindra Bank Ltd & Ors***[20] .The brief facts of Kotak case are that the petitioner filed a reference before the BIFR on 11.05.2002 under Section 15(1) of the Sick Industrial Companies (Special Provisions) Act, 1985 (Sica). The company was declared as a sick company. An application had been filed before the BIFR by the Kotak Mahindra Bank Ltd., hereinafter referred to as KMBL, seeking abatement of the reference made by the petitioner under the third proviso to Section 15(1) of SICA. The application had been filed on the ground that KMBL held more than 3/4th in value of the outstanding secured debts of the petitioner and had also taken action under Section 13(4) of the Securtisation of Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. The application filed by KMBL was allowed by the BIFR and the reference stood abated.

The primary question in Kotak case was nature of interplay between section 13 (9) of the Sarfaesi act and section 15 of the Sica act. A brief reference to the relevant section may be made. Section 13(9) – 'In the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors'. Section 15 (1) of the Sica provides for reference of a sick industrial company to BIFR on the passing of a resolution to that effect by

[18] AIR 2013 Madras 229
[19] M/s. Salem Textiles Ltd Vs. The Authorized Officer, Para No [52]
[20] W.P(C) 4862/2013

the Board of Directors of the company. The second proviso prohibits any reference being made to the BIFR after the introduction of the Sarfaesi Act in the year 2002. The third proviso (with which we are concerned) is as under: -'Provided also that on or after the commencement of the Securtisation and Reconstruction of Financial Assets and Enforcement of Security Interest , 2002, where a reference is pending before the Board for Industrial and Financial Reconstruction, such reference shall abate if the secured creditors, representing not less than three-fourth in value of the amount outstanding against financial assistance disbursed to the borrower of such secured creditors, have taken any measures to recover their secured debt under sub- section (4) of section 13 of that Act'. It was argued on behalf of the borrower that in order for reference to abate under section 15 and for secured creditors to be able to exercise their right under section 13(4) of securtisation act, the condition as laid down in third proviso to section 15 of Sica act should be fulfilled. That is the condition of secured creditors representing not less than $3/4^{th}$ in value of the amount outstanding against financial assistance disbursed to the borrower of such secured creditor , be fulfilled.

However, court disagreed from the given arguments and examined "A first look at both section 13(9) of the Sarfaesi and the 3 rd proviso to section 15 (1) of the Sica shows that they operate in different situations. Section 13 (4) of the Sarfaesi Act, which permits the secured creditor to take any of the measures specified therein, applies subject to two conditions and these are prescribed in section 13(9). The first condition is that "a financial asset" must have been financed by the secured creditor either singly or jointly with other secured creditors. In case it is financed by a single creditor, there would be no difficulty - he can take any of the measures permitted by section 13 (4) without reference to any other person. In a case where the financial asset is financed by more than one secured creditor or where the financial asset is jointly financed by several secured creditors, there is the further condition that action can be taken under section 13(4) only if the exercise of such action is agreed upon by secured creditors representing not less than 3/4ths in value of the amount outstanding. For instance, if a borrower has acquired a machinery under financing by a bank which has lent Rs. 50 lakhs for the acquisition, and no other bank or financial institution has advanced any monies for the acquisition, that bank can take action under section 13 (4) independently because it has financed the financial asset to the extent of 100%. But supposing two banks have advanced Rs. 25 lakhs each to the borrower to enable him to acquire the asset, then none of the two banks can take independent action because none of them has advanced 3/4ths of amount outstanding; they have to join together to take such action. To continue the same example, if Bank "A" has advanced Rs. 10 lakhs, Bank "B" has advanced Rs. 25 lakhs and Bank "C" has advanced the balance of Rs. 15 lakhs, action under section 13 (4) can be taken only if at least Bank "B" and Bank "C" agree or all the three Banks agree; in that case, they would represent more than 3/4ths of the value of the amount outstanding. The series of actions permitted to be taken by the secured creditors is subject to this basic condition being fulfilled. A look at the various "measures" contemplated by section 13 (4) reveals that they all speak of the "secured assets". Subject to fulfilment of the condition prescribed in section 13 (9), the secured creditors can take possession of "the secured assets" or appoint a manager to manage "the secured assets the possession of which has been taken over" or call upon any person who has acquired any of "the secured assets" from the borrower to pay over the monies to them. The taking over of the management of the business, if such a step is taken by the secured creditors who satisfy the condition laid down in section 13 (9), can only be to the extent relatable to the security of the debt, provided the business is

severable. Further the court held "While section 13(9) of the Sarfaesi Act speaks of financing of "a financial asset", the 3rd proviso to section 15(1) of the Sica speaks of "financial assistance disbursed to the borrower of such secured creditors". The reference can only be to the total amount borrowed by the petitioner from all the secured creditors which is outstanding and therefore the enquiry should be to find out if KMBL also satisfies the condition that it shall represent in value not less than 3/4ths of the total amounts borrowed by the petitioner from all secured creditors. It is only then that it can fall within the 3rd proviso and apply to the BIFR for abatement of the reference of the petitioner's reference. Satisfaction by a secured creditor of the condition laid down in section 13(9) of the Sarfaesi Act cannot automatically be taken as satisfaction of the condition prescribed in the 3rd proviso to section 15(1) of the Sica for the simple reason that both conditions prescribe different thresholds."[21] "That leads to the conclusion that section 13(9) of the Sarfaesi Act and the 3rd proviso to section 15(1) of the Sica operates on distinct fields without overlap**."**[22]

Consequently, there is no overlapping between section 15 and section 13(4) and section 13(9). Section 13 (9) read with section 35 of the Sarfaesi act empowers the banks and financial institutions to proceed against the borrower under Sarfaesi act. Notwithstanding section 22 of Sica act, the secured creditors can move against the borrowers under the Sarfaesi act. The conditions mentioned under section 13(9) and section 15 is different, hence fulfilment of one does not lead to compliance of the other as well. The secured creditor can initiate proceeding under Sarfaesi alone, even though the requirement of third proviso to section 15 of sica act is not fulfilled, with the aid of section 35 of Sarfaesi act.

Overiding eefect of the sarfaesi over sica, act

In ***Nabha Industries Ltd. vs. Punjab State Industrial Development Corporation***[23] , a Division Bench of the Punjab and Haryana High Court considered the question whether the provisions of Securitisation Act, will override Sica. The court noted after taking note of the decision of the Orissa High Court in Noble Aqua as well as all other judgments, the Division Bench of the Punjab and Haryana High Court held that the Securitisation Act will override Sica. Further, the Punjab and Haryana High Court held that the mere pendency of a reference before BIFR will not be a bar to proceedings under the Securitisation Act, 2002, though in exceptional situations, where a Scheme is already approved, the issue can be gone into in a writ proceeding

Again in landmark judgment of **Madras Petrochemicals Vs BIFR**, the court held Sarfaesi prevails over Sica act. A detailed perusal of the case is as follows:

1. Observations of the apex court

The court observed that in order to find out if Sarfaesi prevails over Sica, we first need to determine whether Sarfaesi overrides section 22 read with section 32[24] of the Sica , as such

[21] M/S .Global Infrastructure Vs .Kotak Mahindra Bank Ltd & Ors, Para No [8]
[22] M/S .Global Infrastructure Vs .Kotak Mahindra Bank Ltd & Ors,Para[12]
[23] (2010) 154 Comp cases 646 (P&H),
[24] 32. Effect of the Act on other laws.- (1) The provisions of this Act and of any rules or schemes made there under shall have effect notwithstanding anything inconsistent therewith contained in any other law except the provisions of the Foreign Exchange Regulation Act, 1973 (46 of 1973) and the Urban Land (Ceiling and

overriding is only to the extent of the inconsistency between the two enactments. The court considered scope of section 32(contains non-obstante clause) of the Sica act which distinctly lays down that provision of the Sica act would prevail notwithstanding any inconsistency therewith contained in any other law. The inconsistency between two acts according to the Hon'ble Court is triggered by section 22 and section 32 of Sica and third proviso to section 15 on one side and section 35(contains non-obstante clause), section 37 and section 41 of Sarfaesi on the side. To tame this irregularity or inconsistency between Sarfaesi and Sica and to examine if former prevails over the latter; the court undertook a survey of case laws laid down by courts in relation to Sica and its relation with other enactments.

In an early judgment, **Maharashtra Tubes Ltd Vs State Industrial And Investment**[25] the apex court had to deal with Sica provisions vis-a vis the State Financial Corporation 1951. The apex court held that both the acts are special acts, the 1951 dealing with the recovery of debts of a company pre-sickness and the 1985 dealing with such recovery post-sickness. Since both the clause contained non –obstante clause, it was held that the 1985 act, being later in time, would prevail over the 1951 act.

On the other hand in, in **Solidaire India Ltd V. Fairgrowth Financial Services Ltd And Ors**[26]**,** it was the Special Courts (Trail of Offences Relating to Transactions in Securities), 1992 came up for consideration vis-a- vis the Sick Industrial Companies (Special Provision) Act, 1985.The apex court observed that, that Special Courts Act, 1992, being a later enactment and also containing a non-obstante clause, would prevail over sica. The court further stated , Special Court being a later enactment and had the legislature wanted to exclude the provisions of Sica from the ambit of said act, the legislature would have specifically so provided.

In **Jay Engineering Works Ltd V. Industry Facilitation Council and Anr**[27]**,** the time the court had an occasion of considering Interest on Delayed Payment to Small Scale and Ancillary Industrial Undertakings Act, 1993 vis-a-vis the Sica, 1985.Both acts contained non-obstante clause. The court referred to the 1994 amendment to the Sica and held that amending act being later in time than the 1993 act; hence Sica would prevail over Sarfaesi.

In **Ksl Industries Ltd V Arihant Threads Ltd**[28], it was the turn of Recovery of Debts Due to Banks and Financial Institutions Act , 1993 (RDDB&FI) , vis-a-vis the Sica, 1985, the

Regulation) Act, 1976 (33 of 1976)for the time being in force or in the Memorandum or Articles of Association of an industrial company or in any other instrument having effect by virtue of any law other than this Act. (2) Where there has been under any scheme under this Act an amalgamation of a sick industrial company with another company, the provisions of section 72A of the Income-tax Act, 1961 (43 of 1961), shall, subject to the modifications that the power of the Central Government under that section may be exercised by the Board without the Central Government under that section may be exercised by the Board without any recommendation by the specified authority referred to in that section, apply in relation to such amalgamation as they apply in relation to the amalgamation of a company owning an industrial undertaking with another company

[25] (1993)2 SCC 144

[26] (2001) 3 SCC 71

[27] AIR1968CAL407

[28] (2015) 1 SCC 166

court in resolving the controversy , observed that section 34[29](1) of RDDB&FI contains a ***non-obstante clause*** , which means that provisions of section 34 shall have effect notwithstanding anything inconsistent therein with other laws, however, section 34(2) to an extent impedes the effect of non-obstante clause contained in section 34(1) itself. In other words, section 34(2) was an exception to section 34(1). According to section 34(2), provisions of RDDB&FI shall be in addition to and not in derogation of, interalia, Sica act. Thus court held, it is clearly not the intention of the legislature to annul the provisions of Sica act or to let RDDB&FI overrides Sica act. Thus, Sica act would prevail over RDDB&FI act.

Further the court in Madras Petrochemicals case undertook the analysis of the section 37[30] of the Sarfaesi and section 34 of the RDDB&FI act in order to understand there overriding effects. Section 37 states that the act shall be in addition to and not in derogation of four acts, namely, the Companies Act, the Securities Contracts(Regulation) Act, 1956 , the Securities and Exchange Board of India Act, 1992 and the RDDB&FI, 1993. The apex court in Madras Petrochemicals case examining section 37 of Sarfaesi further observed "It is clear that the first three Acts deal with securities generally and the Recovery of Debts Due To Banks and Financial Institutions Act, 1993 deals with recovery of debts due to Banks and Financial Institutions. Interestingly, Section 41 of the Sarfaesi make amendments in three Acts – the Companies Act, the Securities Contracts (Regulation) Act, 1956, and the Sick Industrial Companies (Special Provisions) Act, 1985. It is of great significance that only the first two Acts are included in Section 37 and not the third i.e. the Sick Industrial Companies (Special Provisions) Act, 1985. This is for the obvious reason that the framers of the Securtisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 intended that the Sick Industrial Companies (Special Provisions) Act, 1985 be covered by the non obstante clause contained in Section 35, and not by the exception thereto carved out by Section 37. Further, whereas the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 is expressly mentioned in Section 37, the Sick Industrial Companies (Special Provisions) Act, 1985 is not, making the above position further clear. And this is in stark contrast, as has been stated above, to Section 34(2) of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, which expressly included the Sick Industrial Companies (Special Provisions) Act, 1985. The new legislative scheme *qua* recovery of debts contained

[29] 34. Act to have overriding effect(1) Save as provided under sub-section (2), the provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.(2) The provisions of this Act or the rules made there under shall be in addition to and not in derogation of, the Industrial Finance Corporation Act, 1948 (15 of 1948), the State Financial Corporations Act, 1951 (63 of 1951), the Unit Trust of India Act, 1963 (52 of 1963), the Industrial Reconstruction Bank of India Act, 1984 (62 of 1984), and [18][the Sick Industrial Companies (Special Provisions) Act, 1985 and the Small Industries Development Bank of India Act, 1989.

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

in the Securtisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 has therefore to be given precedence over the Sick Industrial Companies (Special Provisions) Act, 1985, unlike the old scheme for recovery of debts contained in the Recovery of Debts Due to Banks and Financial Institutions Act, 1993."[31]

2. Decision of the apex court

"The resultant position may be stated thus:

1) Section 22 of the sica will continue to apply in case of unsecured creditors seeking to recover their debts from a sick industrial company. This is for the reason that , section 22 of the Sick Industrial Companies (Special Provisions) Act, 1985 will continue to apply in the case of unsecured creditors seeking to recover their debts from a sick industrial company. This is for the reason that the Sick Industrial Companies (Special Provisions) Act, 1985 overrides the provisions of the Recovery of Debts Due To Banks and Financial Institutions Act, 1993.

2. Where a secured creditor of a sick industrial company seeks to recover its debt in the manner provided by Section 13(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, such secured creditor may realise such secured debt under Section 13(4) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, notwithstanding the provisions of Section 22 of the Sick Industrial Companies (Special Provisions) Act, 1985.

3. In a situation where there are more than one secured creditor of a sick industrial company or it has been jointly financed by secured creditors, and at least 60 per cent of such secured creditors in value of the amount outstanding as on a record date do not agree upon exercise of the right to realise their security under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, Section 22 of the Sick Industrial Companies (Special Provisions) Act, 1985 will continue to have full play.

4. Where, under Section 13(9) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, in the case of a sick industrial company having more than one secured creditor or being jointly financed by secured creditors representing 60[32] per cent or more in value of the amount outstanding as on a record date wish to exercise their rights to enforce their security under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, Section 22 of the Sick Industrial Companies (Special Provisions) Act, 1985, being inconsistent with the exercise of such rights, will have no play.

5. Where secured creditors representing not less than 75 per cent in value of the amount outstanding against financial assistance decide to enforce their security under the

[31] Madras Petrochemicals Vs Bifr, Para[34]

[32] 2013 Amendment of section 13(9) "in the opening portion of sub-section (9) and in the Explanation thereto, for the words "three-fourth", occurring at both the places, "sixty-percent" shall be substituted."

Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, any reference pending under the Sick Industrial Companies (Special Provisions) Act, 1985 cannot be proceeded with further – the proceedings under the Sick Industrial Companies (Special Provisions) Act, 1985 will abate."[33]

Thus, the crux of the decision being, unsecured creditors cannot take legal course while reference is pending before the BIFR, in view of bar created by section 22. This is for the reason that Sica overrides RDDB&FIs. However, secured creditors can take legal action under Sarfaesi act notwithstanding reference pending before BIFR and section 22 of the Sica act. In situation where there are more than one secured creditors of a sick industrial company, or it has been jointly financed by secured creditors , then at least 60 percent of such secured creditors in value of the amount outstanding should agree upon exercising their right under section 13(4).However, if there is one single secured creditor , who has singly assisted the financing of financial asset, he is free to exercise his right under section 13(4) without complying with the condition of 60 percent.

The last word

The judgment of Madras Petrochemicals has ushered in such times, when the effect of non-performing assets and dodgy loans were having far-reaching effect on Indian economy. With this judgment, we hope a better sense would prevail over the borrowers. It's a wakeup call for every potential defaulting borrower .The tone and tenor of the decision of the apex court is categorically admonishing one to all the unreliable borrowers. Maybe the time has come when full justice to legislative intent of Sarfaesi act will be done. The urgency of the situation demanded the secured creditors under Sarfaesi be given more teeths. The justification for giving more powers to secured creditors is backed by the ***Report On Trend And Progress Of Banking In India 2011-2012*** [34]for the year ended 30.6.2102 submitted by the Reserve Bank of India to the Central Government .The report provides statistics regarding trends in non-performing assets bank-wise, group-wise. As per the said table, the opening balance of Non-performing Assets in public sector banks for the year 2011-212 was Rs .746 billion but the closing balance for 2011-2102 was Rs. 1172 billion only. And the total amount recovered under Sarfaesi out of all three Acts, namely, Sarfaesi, Sica and RDDB&FI, constituted 70% of the total amount recovered.

Also with the decision of the court in Madras Petrochemicals case, the long-lasting game of who- triumphs –over- whom has finally ended with this judgment of the Hon'ble Court. However, what is interesting to see, how well have the borrowers learnt their lessons from the decision of the court. Along with this, the fears of people who considered Sarfaesi since outset as draconian law, for they believe it is all in the whims and fancies of secured creditors to decided an assets as Non-performing Asset and eventually proceed under section

[33] Madras Petrochemicals Vs Bifr, Para[54]

[34] https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Trend+and+Progress+of+Banking+in+India

13 of the act , reached an unprecedented level. In all sincerity, the fears of anti-Sarfaesi people are not completely baseless. However, the words Of Hon'ble Supreme Court In ***Pegasus Assets Reconstruction P.Ltd V. M/S. Haryana Concast Limited***[35] which out folds as "clear intention of the Parliament expressed in Section 13 of the SARFAESI Act that a secured creditor has the right to enforce its security interest without the intervention of the court or tribunal. At the same time, this Act takes care that in case of grievance, the borrower, which in the case of a company under liquidation would mean the liquidator, will have the right of seeking redressal under Sections 17 and 18 of the SARFAESI Act"[36] helps put rest to some fear of people. And, with deep-dyed faith in our laws and judicial system and, we shall conquer all the remaining fears and unfairness.

[35] Civil Appeal No.3646 of 2011
[36] Pegasus Assets Reconstruction P.Ltd V. M/S. Haryana Concast Limited, Para[25]