

STATE BANK OF INDIA v. SANTOSH GUPTA¹: WHY JAMMU AND KASHMIR BE EXEMPTED FROM CENTRAL LEGISLATIONS PURVIEW?

ABSTRACT

The state of Jammu and Kashmir enjoys a special status in India, however central legislations when they are a subject of the Union list, are treated at par with other states. The Securitisation of Financial Assets and Enforcement of Security Interest Act, 2002 (hereinafter referred to as the 'SARFAESI Act') extends to the whole of India, therefore making it applicable to all the encompassing states and not making any special provision to any state with special status. This note talks about applicability of SARFAESI Act to the state of Jammu and Kashmir. In a recent Judgment by the Jammu and Kashmir High Court, the Court said that the Act is not applicable to Jammu and Kashmir as it enjoys a special status by virtue of Article 370 of the Constitution of India. This caused a dread amongst the Banking Community as this hampered the securitization process and raised many unanswered questions as one cannot acquire property in Jammu and Kashmir if they are not a Domicile of the state, therefore the Act supposedly allowed backdoor acquisition of property in the state of Jammu and Kashmir. This commentary analyses the ramifications of this judgment on the applicability of the Act and the difference made by the consequent Supreme Court Judgment.

Keywords: Banking Community, Jammu and Kashmir, SARFAESI.

STATE BANK OF INDIA v. SANTOSH GUPTA

INTRODUCTION

The present appeal arises out of a judgment of *Bhupinder Singh Sodhi v. Union of India*², passed by the High Court of Jammu & Kashmir at Jammu, where it was that the various key provisions of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (hereinafter referred to as 'SARFAESI') were outside the legislative

¹ State Bank of India v. Santosh Gupta, Arising out of SLP (CIVIL) NOS.30884-30885 OF 2015 and SLP (CIVIL) NOS.30810-30817 OF 2015 (India).

² *Bhupinder Singh Sodhi v. Union of India*, 2015 (1) SLJ 105 (India).

competence of Parliament, as they would collide with Section 140 of the Transfer of Property Act of Jammu & Kashmir, 1920.

In the case of *Bhupinder Singh Sodhi v. Union of India*³, the question of backdoor property acquisition in Jammu and Kashmir came to a head. The primary contention of the case was that by effective mala fide application of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, there was a chance that non-residents of the state could end up owning property in violation of the Transfer of Property laws of the state. This backdoor entry would take away the sovereign nature of the state's function and would be an infringement on its law making and execution. Hence, the petitions claimed that the Jammu and Kashmir Constitution should have primacy over the SARFAESI, and banks (and through them, non-residents of the state,) should not be allowed to own property of any kind in the Jammu and Kashmir region.

After the State Bank of India appealed against the High Court order, the Jammu and Kashmir government submitted in the Supreme Court that this law encroached upon the property rights of permanent residents of the state and it must be read down so that it will not be permissible to sell property belonging to a permanent resident of the state to outsiders. It was also argued that Parliamentary legislation would need concurrence of the Jammu and Kashmir government before it could apply to the state under Article 370.

Since it was also a question of constitutional and national importance, the Supreme Court delivered a very well analyzed decision which we shall now examine.

QUESTION BEFORE THE COURT

The question before the Court was “whether SARFAESI in its application to the State of Jammu and Kashmir would be held to be within the legislative competence of Parliament”.⁴ The Hon'ble Supreme Court deliberated on the question in this case that whether the decision delivered by the High Court of Jammu and Kashmir can be upheld.

³ *Id.*

⁴ *Supra* note 1, at Para 35.

RELEVANT CONSTITUTIONAL PROVISIONS

The Constitution of India divides the legislative powers of the State and Central Legislative Assemblies under Chapter XI⁵. These powers are divided into Three Lists, List 1, List 2 and List 3 commonly called the Union List, State List and Concurrent List respectively. The Central Legislature (Parliament) can legislate on the items mentioned in the Union List. States can legislate on items mentioned in the State List. The Concurrent List, as the name suggests, is to be concurrently legislated upon by both. If there is a clash between the Union and State made law, the Union Law will prevail unequivocally.

The Hon'ble Supreme Court here observed that the Constitution of India commenced on 26 January, 1950. It applied to all other states of India automatically from that date, but it didn't apply to the State of Jammu and Kashmir under Article 394 except directly through Article 370⁶. Article 370 (1) states that the power of Parliament to make laws for Jammu and Kashmir "*shall be limited to-*

- (I) *Those matters in the Union List and the Concurrent List which are declared by the Presidential Order to correspond to matters specified in the Instrument of Accession (i.e. defense, foreign affairs & communication) BUT only in consultation with the State Government and*
- (II) *Such other matters in the said Lists as the Presidential Order may specify BUT only with the concurrence of the State Government."*

CASES EXAMINED

The Hon'ble Supreme Court, to determine the special status of the State of Jammu and Kashmir, looked at prior cases on the question. The 2-judge bench examined the cases of *Prem Nath Kaul v. State of Jammu & Kashmir*⁷ (5-judge bench), *PuranlalLakhanpal v. President of India*⁸ (7-judge bench), and *Sampat Prakash v. State of J&K*⁹ (3-judge bench), and after reading through

⁵ INDIA CONST. chapter XI.

⁶ INDIA CONST. art. 370.

⁷ Prem Nath Kaul v. State of Jammu & Kashmir, AIR 1959 SC 749 (India).

⁸ PuranlalLakhanpal v. President of India, AIR 1961 SC 1519 (India).

⁹ Sampat Prakash v. State of J&K, AIR 1970 SC 1118 (India).

the principles evolved therein, reiterated that the State of Jammu and Kashmir, for historical reasons, enjoys a 'special position' in the Indian Union amongst the states.

The Hon'ble Court further noted that Article 370 of the Constitution of India had initially been proposed as a temporary or transitional provision. It has however now become a 'permanent feature of the Constitution'. This is the case because Article 370(3) specifically states that it cannot be abrogated without the State Constituent Assembly giving its recommendations on the matter. Also, it is important to note that Article 370(2) does not in any manner state that the said Article shall cease on the completion of the work of the Constituent Assembly or its dissolution. Since the State Constituent Assembly was dissolved on 25 January, 1957 without making such a recommendation, Article 370 has stayed permanently in the text of the Indian Constitution since no recommendation to remove it can now be made.¹⁰

VALIDITY OF SARFAESI

The Court further looked into the Act in question, and gathered that SARFAESI basically provides for three things:

- (1) Securitization of financial assets;
- (2) Reconstruction of impaired loan assets and
- (3) Enforcement of security interest.

For the enforcement of security interest, the sale of mortgaged properties of land and structures thereon in case of non-performing assets by the borrower can be effected by Banks or Financial Institutions or by Asset Reconstruction Companies to whom loan asset along with underlying mortgage properties has been sold by bank or Financial Institution by following the procedure prescribed under Section 13¹¹ read with the Security Interest (Enforcement) Rules, 2002 as modified from time to time by the Central government.

The SARFAESI Act has been held to be 'constitutionally valid' in *Mardia Chemicals Ltd v. Union of India*¹². The Hon'ble Supreme Court has, since then, further clarified that this Act has been passed by the Indian Parliament by exercising its legislative power under Entry 45 of the

¹⁰ *Supra* note 1, at Para 12.

¹¹ Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, No. 54, Act of Parliament, 2002.

¹² *Mardia Chemicals v. Union of India*, AIR 2004 SC 2371 (India).

Union List, and for the item 'banking' in particular, which includes not only mobilization of deposits for lending and investment but the creditor's right of recovery in case there is default by the borrower by selling his charged assets as recovery of loan is included in the subject of 'banking'. This is admitted position of law.¹³

Entry 45 has been clearly extended to the State of Jammu and Kashmir by the Presidential Order of 1954, and thus, the Union is empowered to make laws that govern banking decisions in Jammu and Kashmir. There is unanimity on these points in the Supreme Court decisions till now and the Jammu and Kashmir High Court in *Bhupinder Singh Sodhi*¹⁴ has accepted this view too.

APPLICABILITY OF SARFAESI TO JAMMU AND KASHMIR

The Indian Parliament has till date passed legislations (and adopted British era legislations) by exercising its powers under Entry 45. When we look at the opening provisions and jurisdiction clauses of the Acts, such as Reserve Bank of India Act, 1934, Banking Regulation Act, 1949, Negotiable Instruments Act, 1881 and Recovery of Debts Due to Banks and Financial Institutions Act, 1993, we note that each Act begins with the terms- 'This Act shall be applicable to the whole of India except the State of Jammu and Kashmir'. The expression 'except the State of Jammu and Kashmir' in those legislation was originally placed in view of Article 370. These terms were removed by the Jammu and Kashmir (Extension of Laws) Act, 1956 from the said Central laws and then the Extension of Laws Act was passed pursuant to the Presidential order of 1954 to further reinforce the applicability of these Acts to the state according to the procedure required under Article 370(1).

However, the Recovery of Debts Due to Banks & Financial Institutions Act, 1993¹⁵ which also had the terms '...except the State of Jammu and Kashmir...' did not get accepted by the State government in its present form, and hence, has not been adopted by or extended to the State till date. This is a hindrance to the applicability of SARFAESI, since Debt Recovery Tribunal and Debt Recovery Appellate Tribunal are the appellate tribunals for any aggrieved party under the controversial Act.

¹³ Union of India v. Delhi High Court Bar Association, (2002) 4 SCC 275 (India).

¹⁴ *Supra* note at 2.

¹⁵ Recovery of Debts Due to Banks & Financial Institutions Act, 1993, No. 51, Act of Parliament, 1993.

As regards the SARFAESI Act, 2002, the jurisdiction clause doesn't exempt Jammu and Kashmir from its applicability. Hence, when read with how Entry 45 is fully applicable to the state, there can be no doubt that SARFAESI would be applicable to the properties in Jammu and Kashmir as well.

Citizenship Argument

The bench called it 'disturbing' that various parts of a judgment in appeal by the Jammu and Kashmir High Court spoke of the absolute sovereign power of the state. "It is necessary to reiterate that Section 3 of the Constitution of Jammu & Kashmir, which was framed by a Constituent Assembly elected on the basis of universal adult franchise, makes a ringing declaration that the State of Jammu & Kashmir is and shall be an integral part of the Union of India. And this provision is beyond the pale of amendment," the judges said.

The bench also clarified that Jammu and Kashmir residents are 'first and foremost' Indian citizens. "It is therefore wholly incorrect to describe it as being sovereign in the sense of its residents constituting a separate and distinct class in themselves. The residents of Jammu and Kashmir, we need to remind the High Court, are first and foremost citizens of India... permanent residents of the state of Jammu and Kashmir are citizens of India, and that there is no dual citizenship as is contemplated by some other federal Constitutions in other parts of the world," it said.

Transfer of Property Argument

The Hon'ble Court rejected the holding of the High Court and stated that the SARFAESI Act deals with 'banking'. Recovery measures of loans by sale of property is only 'ancillary' to its functions and that 'in pith & substance' it is not relatable to the subject matter of 'transfer of property'.¹⁶ It further stated that the SARFAESI Act is entirely referable to Entries 45 & 95 (latter dealing with jurisdiction & powers of all courts except the Supreme Court) of the Union

¹⁶UCO Bank & Anr. v. Dipak Debbarma & Ors., Civil Appeal No. 11247 of 2016 and Civil Appeal No. 11250 of 2016 (India).

List and it is not correct to first dissect an Act into various parts and then refer those parts to different Entries in the legislative Lists as done in *Bhupinder Singh Sodhi*.¹⁷

The Court also looked into the Jammu and Kashmir Transfer of Property Act, 2002 (hereinafter referred to as ‘the 2002 Act’). Section 140 of the 2002 Act only allows sale of mortgaged property by a creditor to a State Subject. Further, the proviso to Rule 8(5) of the Security Interest (Enforcement) Rules, 2002 also supports this Section. The Hon’ble Court held that this Rule ‘can’t be brushed aside and that Section 140 above will be respected in auction sales’ under the SARFAESI Act and that ‘there is no repugnancy or collision between Section 140 and the SARFAESI Act provisions’. The Court remarked that Rule 8(5) cannot be ‘brushed aside’ as done by *Bhupinder Singh Sodhi*.¹⁸

HOLDING

The Court finally stated that, “anything that comes in the way of SARFAESI by way of a Jammu and Kashmir law must necessarily give way to the said law by virtue of Article 246 of the Constitution of India as extended to Jammu and Kashmir read with Section 5 of the Constitution of Jammu & Kashmir”.¹⁹ It further restated the view that an attempt has first to be made to harmonize Section 140 of the Jammu and Kashmir Transfer of Property Act, 2002 with the SARFAESI, and if such harmonization is impossible, it is clear that by virtue of Article 246 read with Section 5 of the Jammu and Kashmir Constitution, Section 140 of the Jammu and Kashmir Transfer of Property Act has to give way to the SARFAESI, and not the other way around.²⁰

CONCLUSION

Bhupinder Singh Sodhi case had claimed that that the Parliament had no power to enact Sections 17A and 18B in the SARFAESI Act as the ‘administration of justice’ is a State subject. But the Court in *Santosh Gupta* case said unequivocally that the administration of justice is undoubtedly a State subject but Parliament under Entry 95 of the Union List has power to confer jurisdiction

¹⁷ *Supra* note 1, at Paras 32, 33, 37, 44.

¹⁸ *Supra* note 1, at Para 40.

¹⁹ *Supra* note 1, at Para 40.

²⁰ *Supra* note 1, at Para 44.

on the Courts within a State.²¹ It completely rejected all conclusions reached by the High Court in its analysis, and said that the debtors could not escape liability under the Act by merely claiming a property defense.

We should note that since the primary contention was on SARFAESI's applicability, the Court's observations on the lack of sovereignty of Jammu and Kashmir, and the subordination of the state's Constitution to the Indian Constitution²² might be read to be merely obiter dicta. However, the Hon'ble Supreme Court did not mince its words when it said that, "It is clear that the state of Jammu & Kashmir has no vestige of sovereignty outside the Constitution of India and its own Constitution, which is subordinate to the Constitution of India... they (residents of state) are governed first by the Constitution of India and also by the Constitution of Jammu & Kashmir".

The Apex Court pointed out that it was constrained to observe these because in at least three places, the High Court, in its judgment, 'has gone out of its way to refer to a sovereignty which does not exist'. It clarified that the SARFAESI Act deals with recovery of debts due to banks and financial institutions, which is relatable to a subject under the Union List and parliamentary legislation did not require concurrence of the state government since the Centre had power to make law on this subject.

It is evident that there shall be further appeals to the question, and possibly a larger bench of the Supreme Court may be constituted to deal with the question of sovereignty. As of now, it has been clarified adequately that the SARFAESI is applicable to the state. Hence, banks and financial institutions are empowered to enforce their security interests in the state. Debtors and big players cannot escape their clutches by raising sovereignty of Jammu and Kashmir as a defense. There may be further modification required to apply the Recovery of Debts Due to Banks & Financial Institutions Act, 1993 to the state, but that is a question for the Indian Parliament, and not our Courts.

²¹*Supra* note 1, at Para 44.

²²*Supra* note 1, at Para 5.