

## Constitutionality of Section 13 of SARFAESI ACT, 2002

(MARDIA CHEMICALS V. UOI)

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### Abstract

The finance sector has been one of the key drivers in India's efforts to achieve success in rapidly developing economy. While the banking industry in India is progressively complying with the banking and financial prudential norms and accounting practices, there are certain areas in which the banking and financial sectors don't have a level playing field as compared to other participant in the financial market in the world. There are no legal provisions to facilitate securitization of financial assets of banks and financial institutions. Further, unlike International banks, the banks and financial institutions in India don't have the power to take possessions of the securities and sell them. They have to approach civil court for the recovery of dues, which was time consuming. There were huge arrears of cases before civil courts. Civil Courts also failed to deliver both in ascertainment of dues and execution of decree even after judgment.

Failure of Civil Courts led to promulgation of Recovery of Debt Due to Banks and Financial Institutions Act (RDDBFI)<sup>2</sup> w.e.f. 27<sup>th</sup> August 1993. This act provided summary procedure for the settlement of dues towards the banks and certainly brought down the time of adjudication in such matters. Banks and Financial Institutions are the custodian of the public money and there was need to rotate the money for the Public good. Non Performing Assets is a loss to the country.

By the late 90s rising level of Bank NPAs raised concerns. Government constituted Narsimhan Committee for the purpose of examination of banking sector reforms. The Committee suggested that there is a need to enact a new law for the purpose of securitization and empowering banking legislations. Acting on these suggestions, The SARFAESI Ordinance 2002, was promulgated on 21<sup>st</sup> June, 2002, to regulate securitizations and reconstruction of financial assets and enforcement of security interest. The provisions of the ordinance would enable banks and financial institutions to realize long terms assets, mange problem of liquidity, assets liability mismatches and improve recovery by taking possession of the securities, sell them and reduce nonperforming assets by adopting measure for recovery or reconstruction. Later on Ordinance was replaced by bill, which was passed by both the houses of parliament and receive the assent of the President on 17<sup>th</sup> December 2002, and came into force same day.

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<sup>2</sup> MINISTRY OF LAW AND JUSTICE, *RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTIONS ACT*, Government of India, (March 09, 2018, 7:10PM), <http://www.drat.tn.nic.in/Docu/RDDBFI-Act.pdf>

## Section 13 of SARFAESI

This sections deals with the enforcement of security interest. According to subsection 1, the secured creditor can enforce his right without the intervention of the court. According to subsection 2, the secured creditor need to send a notice of at least 60 days to the borrowers stating his intention to enforce the security interest. If the borrower is unable to clear the debt, the creditor will be entitled to take the actions as specified under Section 13(4). Section13 subsection 3 talks about disclosures which are required in the notice. Section 13 (3A) which was added after the case of *Mardia Chemicals v. UOI*, will be discussed later on. Section 13(4) talks about different measures which can be taken by the secured creditor to enforce the security interest. Like taking possession of the property, taking over the management, appoint any person or recover his debt from the debtor of the borrower. Remaining subsections from 5-12 deals with procedure relating to security enforcement<sup>3</sup>.

### Case Analysis

In *Mardia Chemicals v. Union of India*, 2004(4) SCC 311, the Apex Court had the opportunity to consider the constitutionality of Section 13 of the Act. In the case petitioner contended that the sale of secured asset for the enforcement of secured interest is an exception to the common law principle and Section13 empowers the borrower with the unchecked arbitrary powers since “before any action is taken under section 13, there is no forum or adjudication mechanism to resolve any dispute which may arise in respect of alleged dues or the Non Performing Assets. The Court rejected the intention of the petitioner and observed that “NPAs due from industrial units is a serious issue. In the present day global economy it may be difficult to stick to old and conventional methods of financing and recover of debts.

Court held that it cannot be said that a step taken towards securitization of the debts and to evolve means for faster recovery of the NPA’s was not called for or that it was super imposition of undesired law since one legislation was already operating in the field namely “Recovery of Debts due to Banks and Financial Sectors”.

The court further held that, “NPAs problem is an important issue regarding the growth in particular, the fact that the financial sector in particular, the fact that NPA’s have reached an alarming proposition was noted by several committees and institutions dealing with financial sector. Court also held that any law which doesn’t give the the other party to represent his case would be stuck down of Article 14 of the Indian Constitution.

There should be some internal mechanism which provides safeguard for a borrower, before a secured asset is classified as Non Performing Asset. It held that such internal mechanism must be

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<sup>3</sup> MINISTRY OF LAW AND JUSTICE, *SARFAESI ACT*, Government of India, (March 19, 2018, 9:10PM), <http://www.drat.tn.nic.in/Docu/Securitisation-Act.pdf>

included in the Act by mandating that the creditor must apply its mind to the objections raised in the reply to such notice and an internal mechanism must be particularly evolved to consider such objections raised in the reply of the notice.

In accordance with the observation of the Supreme Court in this case, Section 13(3A) was inserted in the Act through an ordinance in 2004.

Now According to Section 13(3A), if on receipt of any notice under Section 13(2) of the Act, the borrower makes any representation where he mentions the reason that why he was unable to pay the debt, then in that case, the secured creditor must response within 15 days of such representation.

Creditor can either accept the contentions of the borrower or reject it. Rejection of representation under this section doesn't entitle the borrower to file an appeal to the DRT under Section 17 of the Act.

### **Conclusion**

With the enactment of SARFAESI Act, the powers of the secured creditors have increased significantly. Now creditors need not to worry about the recovery of their debt. Filing an application under SARFAESI is more than sufficient to recover the debt. Act also provides that such matters must be solved in an expeditious manner.

Validity and Constitutionality of Section 13 was justified by Supreme Court in the case of *Mardia Chemicals v. UOI*<sup>4</sup>. Court correctly observed that Securitization and Reconstruction of Financial Assets are important for the growth and development of any economy. SARFAESI is a powerful legislation which is being successful in fulfilling its objective.

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<sup>4</sup> 2004(4) SCC 311