Construction of the Reconstruction Act - G.S.Hedge

In the case of Mardia chemicals[1], the Supreme Court upheld the constitutional validity of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002) (for short, 'the Act') except subsection (2) of section 17 of the Act under which the Debts Recovery Tribunal (Tribunal) shall not entertain the appeal unless the borrower deposits with Tribunal, 75% of the amount claimed in the notice issued under subsection (2) of section 13.

2. This paper attempts to analyse the reasons given by the Hon Supreme Court, for holding subsection (2) of section 17 of the Act as unreasonable, arbitrary and violative of Article 14 of the Constitution.

Grounds of Challenge

3. The main grounds of challenge to Section 17 were as under.

(i) The remedy before the Tribunal under section 17 of the Act is illusory, as it is burdened with the onerous and oppressive condition of deposit of 75% of the amount of demand, before the Tribunal can entertain the appeal.

(ii) That provision impedes access to the Tribunal which is meant for redressal of the grievance of a borrower

1. Mardia Chemicals Ltd Etc. v. Union of India and others, JT 2004 (4) SC 308.

2. Seth Nandial v. State of Haryana, 1980 (Supp.) SCC 574, Anant Mills Co. Ltd. v. State of Gujarat, 1975 (2) SCC 175 at p. 202, Vijay Prakash D. Mehta and Anr. v. Collector of Customs (Preventive) Bombay, 1988(4) SCC p. 402.

(iii) Where the possession of the secured assets or the management of the secured assets of the borrower, including the right to transfer the same has already been taken over, it is not at all necessary to burden the borrower doubly with deposit of 75% of the demand amount.

(iv) It would not be possible for a borrower to raise funds to deposit the huge amount of 75% of the demand, once he is deprived of the possession/management of the secured assets.

The Answer

4. The said challenge was sought to be met on the following grounds.

a) The condition of pre-deposit has been held to be valid by the Supreme Court in many cases[2].

b) Under the proviso to subsection (2) of section 17, the Tribunal has the power to waive or reduce the amount. The Tribunal, which is presided over by a Member of the Higher Judicial Service, would exercise its discretion and may waive or reduce, in deserving cases, the amount required to be deposited.

c) The secured assets, which may be taken possession of or sold, may fall short of the dues.

d) The right of appeal is a statutory right and it can be circumscribed by the conditions.

Suits v. Appeals

5. The Court observed that the reference to the remedy provided under section 17 of the Act as an appeal is a misnomer. It is the initial action, which is brought before a forum as provided under the Act for raising grievance against the action or measures taken by one of the parties to the contract. It is the stage of initial proceeding like filing a suit. The requirement of pre-deposit at the stage of initiation of proceedings does not stand on the same footing as the requirement of pre-deposit at the stage of filing appeal.

6. The Supreme Court quoted with approval the observations made by it in Smt. Ganga Bai & Others v. Vijay Kumar and others [3] regarding the distinction between the right of suit and the right of appeal. There is an inherent right in every person to bring a suit of civil nature. A suit for its maintainability requires no authority of law and it is enough that no statute bars a suit. The position in regard to appeals is quite the opposite. An appeal for its maintainability must have the clear authority of law. The requirement of pre-deposit at the stage of initiation of proceedings impedes the inherent right of a party to approach a judicial forum for redressing his grievances. If the law provides that an appeal can be filed only upon depositing a portion of the amount in dispute, such a law is valid as it conferred on the party (though subject to pre-deposit), a right to appeal that was not there, but for such law.

3. (1974) 2 SCC 393.

4. Seth Nandial v. State of Haryana, 1980 (Supp.) SCC 574, Anant Mills Co. Ltd. v. State of Gujarat, 1975 (2) SCC 175 at p. 202, Vijay Prakash D. Mehta and Anr. v. Collector of Customs (Preventive) Bombay, 1988(4) SCC p. 402.

5. Order XXXVIII rules 5 and 6 of the Code of Civil Procedure, 1908.

6. Order XL rule 1 ibid.

7. Order XXXIX ibid.

8. " In section 17 of the principal Act,-(a) in sub-section (1),-
(i) for the words "may prefer an appeal", the words "may make an application along with such fee, as may be prescribed," shall be substituted and shall be deemed to have been substituted with effect from the 21st day of June, 2002;"

7. The decisions [4] relied upon by the respondents relate to appeals. In suits, under the Code of Civil Procedure, it is permissible to attach[5] the property before the judgement is passed or to appoint receivers[6] and to make provision by way of interim measure[7] in respect of the property, before decree. For obtaining such orders, a case has to be made out in accordance with the relevant provisions of the Code of Civil Procedure. There is no such provision in the Act.

Reasons

8. In view of the following, the Court concluded that the condition of pre-deposit is bad, rendering the remedy illusory.

- It is imposed while approaching the adjudicating authority of the first instance, not an appeal.
- There is no determination of the amount due as yet.
- The secured assets or its management with transferable interest is already taken over and is under the control of the secured creditor.
- There is no special reason for requiring double security in respect of amount due yet to be determined and settled.
- 75% of the amount claimed by no means would be a meagre amount.
- It would leave the borrower in a position where it would not be possible for him to raise the funds to make deposit of 75% of the undetermined demand.
- Such conditions are not only onerous and oppressive but also unreasonable and arbitrary.

Amendment

9. By the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Ordinance, 2004 , Section 17 has since been amended[8]. The petition to the Tribunal under that Section is now being referred to as an application and not as an appeal. It is now provided[9] that the Appellate Tribunal shall not entertain the appeal of the borrower unless the borrower deposits 50% of the amount of debt due from him or the amount determined by the Debts Recovery Tribunal, whichever is less.
10. It may be expected that since the requirement of pre-deposit is now at the appellate stage and the amount to be deposited is also reduced to 50% which may further be reduced to 25% by the Appellate Tribunal, the amended provisions would be held as constitutionally valid.

9. "Provided further that no appeal shall be entertained unless the borrower has deposited with the Appellate Tribunal fifty per cent. of the amount of debt due from him, as claimed by the secured creditors or determined by the Debts Recovery Tribunal, whichever is less:
Provided also that the Appellate Tribunal may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent. of debt referred to in the second proviso."

10. Andhyarujina Committee.

11. Narasimham Committee I and II and Andhyarujina Committee constituted by the Central Government for the purpose of examining banking sector reforms.

12. The Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Ordinance, 2004

13. "(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 non-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:
Provided further that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt."

14. ibid.

Committees

11. It is submitted that the Court has noted that the question of non-recoverable or delayed recovery of, debts advanced by banks and financial institutions had been attracting the attention of Government of India and RBI and that the matter was considered in-depth by the committee[10] consisting of experts in the field specially constituted. The Court rightly upheld the validity of the Act, which was passed after taking into consideration the recommendations of various committees[11] of experts and considering the totality of circumstances and the financial climate in the country.

Section 13 Is Valid

12. Even though the text of section 13 does not contemplate the communication of reasons for not accepting the objections of the borrower, the Court said that it goes with logical reason that before the secured creditor takes the measures like taking over possession of the secured assets, he communicates to borrower, the reasons for not accepting his objections. The Court rightly held that it is necessary to communicate the reasons for not accepting the objections raised by the borrower in reply to the notice issued to him under subsection (2) of section 13 of the Act.
The Court rightly noted that the requirement to communicate the reasons to the borrower is in keeping with the concept of right to know and lenders' liability. Such a measure, the court felt, caters to the cause of transparency and is conducive to building up of confidence in the commercial practices. The Court had no hesitation in holding that such a safeguard was inherent under section 13 of the Act. The Court has in fact read down the provisions of section 13 by requiring the secured creditor to give reasons and thereby made the provisions of that section logical and reasonable. Section 13 has since been amended[12] and the secured creditor is now required[13] to communicate the reasons to the borrower for not accepting his objections.

13. The second proviso[14] to subsection (3A) of section 13 clearly states that the borrower does not get the right to make an application to the Tribunal on the secured creditor communicating the reasons for not accepting the objections. The
explanation added to Section 17[15] is also to the same effect and makes it clear that the borrower cannot approach the Tribunal immediately after the communication of the reasons and thwart the recovery process.

What is Reading Down?

14. The Supreme Court[16] has explained the concept of reading down of the statutes while upholding the constitutional validity of section 23 of the Urban Land Ceiling Act. Section 23 of that Act provided for the allotment of acquired vacant land by the State Government. Dealing with the challenge to the said provisions on the ground that compulsory acquisition of property from some private owners for transferring to other private owners would not be in public interest and is susceptible to misuse, the Court observed as under.

'If the power is used for favouring a private industrialist or for nepotistic reasons the oblique act will meet with its judicial Waterloo. To presume as probable graft, nepotism, patronage, political clout, friendly pressure or corrupt purpose is impermissible. The law will be good, the power will be impeccable but if the particular act of allotment is mala fide or beyond the statutory and constitutional parameters such exercise will be a casualty in court and will be struck down. We must interpret wide words used in a statute by reading them down to fit into the constitutional mould. The confusion between the power and its oblique exercise is an intellectual fallacy we must guard against. Fanciful possibilities, freak exercise and speculative aberrations are not realistic enough for constitutional invalidation.'

15. "Explanation.- For the removal of doubts it is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action of the secured creditor at the stage of communication of reasons to the borrower shall not entitle the person (including borrower) to make an application to the Debts Recovery Tribunal under sub-section (1) of section 17."

16. Bhim Singhji v. Union of India, 1981(1) SCC166 = AIR 1981 SC 234.
(Emphasis added)

'To sustain a law by interpretation is the rule. To be trigger-happy in shooting at sight every suspect law is judicial legicide. Courts can and must interpret words and read their meanings so that public good is promoted and power misuse is interdicted. "As Lord Denning said : 'A judge should not be a servant of the words used. He should not be a mere mechanic in the powerhouse of semantics'. May Lord Denning live long, and his shadow never grow less!" "Lawyer" October 1980 Silver Jubilee Issue, p. 172' (Emphasis added).

In the light of the above, it ought to have been brought to the notice of the Court that section17 of the Act was a fit case for reading down. The discretion vested in the Tribunal to waive or reduce the amount to be deposited with it before entertaining the proceedings under section 17, could be read as requiring the Tribunal to take into consideration, inter alia, the value of the secured assets which have been repossessed or sold and the terms and conditions which could be imposed to protect the interest of both the borrower and the creditor, while passing the order on the application for waiving or reducing the amount to be deposited. In other words, it ought to have been pointed out that the provisions of subsection (2) of section

17 have to be read down as requiring the Tribunal to take into consideration the value of the secured assets, the management of which has been taken over by the secured creditor or which is repossessed by the secured creditor or sold by the secured creditor and adjust the same against the amount required to be deposited with it under that section. That would have ensured that the secured creditor does not get double protection of the possession or management of the secured assets and the deposit of money.

Perhaps, the contention of the borrowers that it is impossible for them to arrange for 75% of the demand amount after the possession of the secured assets is taken over by the creditor could have been analysed with reference to one of the main causes for default, namely, diversion of funds. The Tribunal could have been required to examine while passing an order on an application for waiving or reducing the amount to be deposited, whether there is any evidence to show that the borrower had diverted the funds. If the Tribunal found any such evidence in any particular case, the Tribunal would be justified in requiring the borrower to deposit 75% of the demand amount even though the secured assets have been taken over by the creditor. The Tribunal, which is presided over by a Member of the Higher Judicial Service could have been reasonably expected to exercise its discretion to meet the ends of justice in a given case.

The Supreme Court[17] has observed in a recent case[18] that a court should not be overzealous in searching ambiguities or obscurities in words, which are plain. It is also stated that it is well settled that when an expression is capable of more than one meaning, the court would attempt to resolve the ambiguities in a manner consistent with the purpose of the provisions and with regard to the consequences of the alternative constructions[19]. If these principles were applied in the case of Mardia chemicals, the validity of section 17 of the Reconstruction Act could have been upheld.

Tax and Dues of Banks and Financial Institutions

18. Income Tax Act contains provisions[20] for payment of tax in advance. It is not disputed that tax being an amount due to the sovereign, stands on a different footing than the amount to be

17. Tata Consultancy Services v. State of Andhra Pradesh (2005) 1 SCC 308.

18. Where it has examined the question whether the software and computer programs written on CDs and other media are goods for the purposes of the Andhra Pradesh General Sales Tax Act

19. (2005) 1 SCC 308, paragraph 68 at page 339

20. Sections 207 and 208.

recovered by banks and financial institutions. However, in view of the special status of banks and financial institutions and their utility to the economy, the requirement to pay 75% of the claim before the Tribunal could have been considered as reasonable. Further, the safeguard provided to the borrower in the proviso to subsection (2) of section 17 of the Act (power with the Tribunal to waive or reduce the amount to be deposited by recording reasons in writing) ought to have been held to be sufficient.

Is Section 17 Really Different from Code of Civil Procedure?

19. The discretion vested in the Tribunal to waive or reduce the amount required to be deposited is similar to the power conferred on a civil court to attach properties before decree. Under the Code of Civil Procedure, the creditor has to satisfy the Court to obtain an order for attachment of properties (of the debtor) before the judgement. Under section 17 of the Act the debtor has to satisfy the Tribunal that there are grounds for waiving or reducing the amount to be deposited. The difference between the two provisions is only in respect of the burden of proof.
It may be appreciated that the borrowers invariably apply for waiving or reducing the amount to be deposited under section 17. The borrowers would deposit the amount only after the Tribunal rejects their application for waiving or reducing the amount to be deposited. In practical terms therefore, the borrowers would be required to deposit the amount only after the Tribunal which is presided over by a Member of the Higher Judicial Service passes an order on the application for waiving or reducing the amount to deposited. There is no doubt that the Supreme Court could have laid down as to what are the relevant factors to be taken into consideration by Tribunal before exercising the discretion conferred on it under the statute.

20. The requirement to deposit 75% of the claim was obviously a step calculated to improve recovery by banks and financial institutions for recycling the funds in the interest of the economy. The quashing of the said provision seriously affects recovery by banks and financial institutions.

Conclusion

21. The amendments since carried out in the Act remedy the defects pointed out by the Supreme Court in the above judgement. The said amendments provide a reasonable protection to the borrowers. Though the amount required to be deposited is postponed to the stage of appeal and the amount required to be deposited is reduced to 50% as against 75% at the initial stage before the Tribunal itself (under the erstwhile provisions), the amendments may be expected to help recovery as there is sufficient disincentive to the borrowers to file appeals to avoid or postpone recovery. The amendment may be regarded as a balanced step in the right direction.

Men are not hang'd for stealing Horses, but that Horses may not be stolen.

— **SAVILE, George, The Complete Works of George Savile, First Marquess of Halifax, edited with an introduction by Walter Releigh (Oxford : Clarendon Press, 1912), ';Of Punishment,'; p. 229**

It is better for all the world if, instead of waiting to execute degenerate offspring for crime, or to let them starve for their imbecility, society can prevent those who are manifestly unfit from continuing their kind. The principle that sustains compulsory vaccination is broad enough to cover cutting the Fallopian tubes. . . . Three generations of imbeciles are enough.

—HO LMES, Oliver Wendell, in Buck v. Beil, 274 U.S. 200, 207 (1927)

The contention that an injury can amount to a crime only when inflicted by intention is no provincial or transient notion.

—JACKSON, Robert H., in Morissette v. United States, 342 U.S. 246, 250 (1952)