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The Evolution & Development of Recovery Laws in India: A Critical Analysis

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ABSTRACT

Debt can be defined as the loan taken by an individual or an organization from the bank or financial institutions to meet its expenses, start a new business, buy a new house or vehicle etc. The person or organization taking the loan is called as the debtor and the lender is called as a creditor. Many a times the debtor is not able to repay the creditor its principal amount or the interest amount due to losses in business or due to other possible reasons. In such cases the creditor might try to settle the issue in person or approach the court to intervene and help them recover their money.

I. INTRODUCTION

The concept of 'recovery of dues' from the borrowers/guarantors has got two phases. The **first phase** is termed as 'soft recovery', wherein the bankers adopt soft techniques for recovery of dues such as issuing letters to borrowers, meeting them in person, visit to their residence or place of business or office, etc. In this stage, the bankers are not adopting the strict enforcement of legal provisions, but pursuing the borrowers/guarantors to repay their dues without resorting to the legal proceedings. In the **second phase**, the bankers are resorting to the enforcement of legal proceedings before the appropriate judicial forum for adjudication of their dues.

The evolution and development of recovery laws may be understood by the following 4 stages: -

Stage 1: - Before the enactment of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI)

It is noticeable that prior to the enactment of the RDDBFI Act, the normal remedy for recovery of debts due to banks and financial Institution was twofold i.e. either to institute a suit in Civil Court which was tried & decided in accordance with the procedure laid down in the Civil Procedure Code under Order XXXVII that deals with summary procedure or to file a suit for foreclosure under the Transfer of Property Act. Often it took years and decades to

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recover the amount & after such a long period spent in adjudication of liability there was considerable difficulty at the time of execution for recovery of the loan amount or sale of goods/property.

Therefore, due to the above reason two committees were enacted which had the objective to examine the difficulties faced by banks and financial institutions in recovering their loans.

Stage 2: - RRDFI Act was enacted on the recommendation of two committees.

The existing procedure for recovery of debts due to banks & financial institutions blocked a significant portion of their funds in productive assets, the value of which deteriorates with the passage of time. In 1981 a committee under the chairmanship of T. Tiwari examined the legal & other difficulties faced by banks and financial institutions. It suggested speedy disposal of the cases pending. After that in 1991 the Committee on the Financial System headed Shri M.Narasimham had considered the setting up of Special Tribunals with special power for adjudication of such matter & speedy recovery as critical to the successful implementation of the financial sector reforms. Based on these reports the Recovery of Debts due to Banks and Financial Institutions was passed by both the houses of parliament on 27th Aug, 1993. It come into force on 24th June, 1993.

The RDDBFI Act, 1993 was enacted with an object to provide for expeditious adjudication and recovery of debts due to banks and financial institutions through Debt Recovery Tribunal (DRT) and Debt Recovery Appellate Tribunal (DRAT). As a consequence, to the establishment of tribunals, the cases pending before the civil courts above Rs.10 lakhs and decreed cases above Rs.10 lakhs had been transferred to the DRT's.

Constitutional Validity of RDDBFI Act, 1993 Challenged: After 9 years of the evolution of the act the Constitutional Validity of the Act was challenged in ***Union of India & Anr. Vs. Delhi High Court Bar Association & Ors***[2]**.**

The validity of the Act was challenged on the ground of unreasonableness and it was also violative of Article 14 of the Constitution and that the same was beyond the legislative power of the Parliament.

Held: It was held by the Supreme Court that "While Article 323A & 323B specifically enable the legislature to enact laws for the establishment of tribunals, in relation to the matter specified therein the power of the parliament to enact a law constituting a tribunal like a banking tribunal is not taken away".

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[2] Union of India & Anr. v Delhi High Court Bar Association & Ors, (2002) 4 S.C.C. 275.

It was further observed that in exercise of its legislative power the parliament can provide the mechanism by which monies due to banks and financial institutions can be recovered and hence upheld the validity of the Act.

An analysis of the number of dues recovered through DRT, revealed that the entire process of recovery of overdue loans through DRTs doesn't show much progress in spite of the functioning of the full-fledged Debt Recovery Tribunals. One of the reasons for such slow progress in recovery is the procedural delay in DRT in disposing off cases and lack of required powers and skill on the part of the Banks/Financial Institutions to enforce the securities without approaching the Courts.

Stage 3: - Enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)

In **1998**, the **Narsimham Committee - II** was made along with the **Adhyarujana Committee** which was constituted by the central government for the purpose of examining banking sector reforms having considered the need for a change in the legal system. These Committees suggested enactment of a new legislation for securitization and empowering banks and financial institutions to take possession of the securities and sell them without the intervention of the court.

Based on these recommendations the Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Ordinance, 2002 was made and the bill was passed. It received the assent of the President on 17th Dec., 2002 which came into force on 21st June, 2002 as **The Securitization & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002 (SARFAESI).**

Securitization is the process of taking an illiquid asset, or group of assets, and through financial engineering, transforming it into a security. It refers to the process by which groups of such illiquid assets (usually debts) are packaged, bought, securitized and sold to investors.[3]

Asset reconstruction means acquisition by any securitization company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance.[4]

Enforcement of Security Interest: The SARFAESI Act empowers the lender (banker),

[3] S. 2(z), The Securitization & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002, No. 54, Acts of Parliament, 2002 (India).

[4] S. 2(b), The Securitization & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002, No. 54, Acts of Parliament, 2002 (India).

when the borrower defaults, to issue notice to the defaulting borrower and guarantor, calling to repay the debt within 60 days from the date of the notice. If the borrower fails to comply with the notice, the bank or the financial institution may enforce security interests by following the provisions of the Act:

a) Take possession of the security;

b) Sale or lease or assign the right over the security;

c) Appoint Manager to manage the security;

d) Ask any debtors of the borrower to pay any sum due to the borrower.[5]

Constitutional Validity of the SARFAESI Act: In ***Mardia Chemicals Ltd Vs. Union of India & Ors***.[6] The validity of the act was challenged although section 13, 17, 15, & 34 were the ones of which the vires was challenged.

In this the petitioner company owed banks of over 1400 crore rupees due to its inability to pay off the debts. The banks declared the company as a Non-Performing Asset (NPA) which means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss assets, in accordance with the directions or under guidelines relating to assets classification issued by the Reserve Bank.

A notice was served by the Industrial Development Bank of India (IDBI) on 24th July, 2002 under S.13 of the SARFAESI ordinance in force. The notice required the company to pay the arrears within 60 days, failing which the IDBI would be entitled to enforce the security interest without the intervention of the court. The company had on option under section 17 to file an appeal but could not do so as the act required the borrowers to deposit 75% of the amount claimed by the lenders before they could file an appeal.

The **Apex Court held** that after service of 60 days' notice under section 13(2) before the proceeding to take any action; if the borrower raises any objection then such reply must be considered with due application of mind & reasons for not accepting the objection must be communicated to the borrower. The Supreme Court upheld section 13 and with regards to section 17(2) the 75% deposit amount which is necessary to be claimed before filing an appeal was illusionary and unreasonable and therefore was struck down as it was ultra vires of Article 14 of the Constitution of India.

Stage 4: - Enactment of the Insolvency and Bankruptcy Code, 2016

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[5] S. 13, The Securitization & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002, No. 54, Acts of Parliament, 2002 (India).
[6] Mardia Chemicals Ltd v Union of India & Ors, (2004) 4 S.C.C. 311.

In **2016**, the Government of India on 28th May, 2016 passed the **Insolvency and Bankruptcy Code** with the purpose to reorganize the insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner.

Due to this the **Enforcement of Security Laws and Recovery of Debt Laws Miscellaneous Provisions (Amendment) Act, 2016** was passed by the government of India which amended both the RDDBFI Act, 1993 & SARFAESI Act, 2002. The name of the RDDBFI Act was changed to Recovery of Debts and Bankruptcy Act, 1993.

The Insolvency and Bankruptcy code was introduced in 2016 due to the failure of the existing laws and the mounting up of NPAs in the public sector banks. IBC gave a new policy structure to the rehabilitation and liquidation process, thus giving a strong exit structure for business and investors. Under the IBC, there are 5 steps to solve the rehabilitation and liquidation problem.

Step 1 – Application to NCLT

A company is called as an insolvent when it is not able to pay back its debt or losses which are more than the net worth of the company. In such cases a **financial creditor** (a person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred)[7], an **operational creditor** (any person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred)[8] or the company itself (also known as Corporate Debtor) can submit an application to the National Company Law Tribunal (NCLT) to start the insolvency process also known as a Corporate Insolvency Resolution Process (CRIP). NCLT has to accept or reject the application within 14 days of the application submission. The creditor can file the application only if the company's default in payment is more than 1 lakh rupees. Financial and operational creditors have different criteria for qualifying to submit the application.

Step 2 – Starting of CRIP

Once the application is approved by NCLT or NCLAT, the board of directors are suspended and the management is placed under the control of an Interim Resolution Professional also known as IRP. Management does not have any control over the company while the company is under CRIP.

Step 3 – Creation of Committee of Creditors (CoC)

Once the company is into CRIP, within 30 days of its admission, the IRP has to verify the

[7] S. 5(7), The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India).
[8] S. 5(20), The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India).

claims made by all the creditors and form a team of all the financial creditors called as Committee of Creditors (CoC).

Step 4 – Appointment of Resolution Professional

Once the CoC has been formed, the committee appoints a Resolution Professional known as RP which may be same as the IRP depending upon the discretion of the CoC.

Step 5 – Formulation of Resolution plan or Liquidation

Within 180 days of starting of the CRIP a resolution plan needs to be prepared and approved by 75% of the creditors and the NCLT. The NCLT may extend this time by an additional 90 days. Any person including the former management, or creditors, or RP or a third party can propose a resolution plan and it would be the responsibility of the RP to check its feasibility with the IBC and get it approved by NCLT.

Once approved the plan is binding on all the stakeholders involved in the process of CRIP. If no plan is approved by the CoC and the NCLT within the stipulated time frame, then the NCLT will order for the liquidation of the company.

The **Constitutional Validity of the Insolvency and Bankruptcy Code, 2016 was challenged** in the case of ***Swiss Robbins Private Limited & Anr. Vs. Union of India & Ors.***[9]

The Supreme Court upheld the validity by delivering the judgment on 25th Jan, 2019. It held that the Insolvency and Bankruptcy Code is a beneficial legislation which puts corporate debtor back on its feet, not being a mere recovery legislation for the creditors. The Apex Court noted that it is the first and foremost code for reorganization and insolvency resolution of corporate debtors. It also held that there is nothing arbitrary or discriminatory about the classification between the financial and operational creditors and nor is violative of Article 14 of the Constitution and emphasized lastly on the fact that there is an intelligible difference between the two creditors.

II. Conclusion

After the amendments in the SARFAESI, RDDBFI & IBC, the government and regulators such as the Reserve Bank of India are working on various measures to improve the enforcement of the provisions of the recovery laws. Although out of the three laws that explicitly provide for the recovery of debts IBC is a more time and deadline-based process which helps in quicker resolution to the creditors of the defaulting company by giving ample

[9] Judgment, Swiss Robbins Private Limited & Anr. v. Union of India & Ors (Jan. 25, 2019), https://sci.gov.in/supremecourt/2018/4653/4653_2018_Judgement_25-Jan-2019.pdf.

opportunity for rehabilitation.

> *"Law and order exist for the purpose of establishing justice and when they fail in this purpose, they become the dangerously structured dams that block the flow of social progress."*
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> \- ***Martin Luther King Jr.***

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