

RIGHTS OF SECURED CREDITOR UNDER THE SECURITISATION ACT AGAINST TENANTED SECURED ASSET

Supreme Court Judgment on *Harsh Govardhan Sondagar v. International Assets Reconstruction Company Ltd* -- A Shot In The Arm For Banks To Take Possession Of Secured Assets Occupied By Tenants

BACKGROUND:

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (the "**SARFAESI Act**") confers power to the Banks to take possession and sell the secured assets without resorting to filing cases in Courts or the Debt Recovery Tribunal ("**DRT**"). However, the recovery process has been plagued by problems of recovery of possession of the **secured assets** due to persons inducted into the secured properties as Tenants, lessees, licensees, etc. ("**Tenant**" or "**Tenants**"). Quite often, Tenants have been set up and inducted by the Borrowers after the creation of the mortgage by creating/antedating documents, with a view to defraud the Banks and impede the taking of possession or sale by the Bank in the event of default. It is also not uncommon to find that Tenants have been **inducted into the property, even after the Banks have issued a notice under Section 13(2) of the SARFAESI Act** demanding payment of their dues after the account has been declared as a Non Performing Asset ("**NPA**"). These Tenants would resist efforts of the Bank to take possession of the property by contending that they cannot be dispossessed except by following due process of law i.e. after a civil suit/eviction petition has been filed in a regular Civil Court/House Rent Control Court and a decree/order of eviction has been passed. Such litigation would take a long time and consequently delay the process of recovery. Therefore, such resistance by Tenants would force the Banks to cause the sale of secured assets without taking possession and conveying the property to purchasers with such Tenants, which in turn would impede the ability of the Borrower to sell the secured asset to prospective purchasers and lead to a significant depreciation in the price obtained in the sale from prospective purchasers who are willing to buy the property with such risks.

In the past, Banks have tried to approach the Chief Judicial Magistrate/District Magistrate under Section 14 of the SARFAESI Act and obtained orders for assistance to take possession of the secured asset from Tenants with the help of the Police. However, decisions of some of the High Courts have come to the aid of Tenants, which have held that such persons ought to be dispossessed only by following due process of law, through the normal procedure of filing a suit/eviction petition and that the Chief Judicial Magistrate/District Magistrate cannot decide on the validity, tenure of the lease or determine their right to possession. It was also held in some cases that the Tenants could approach the DRT against action of the Banks to dispossess them and that the DRT could then decide on the rights of the Tenants. The DRT's are already burdened with backlog of pending cases and their efficiency in facilitating speedy recovery has come under much criticism, which was one of the very reasons why it was decided to allow Banks to directly take possession of the secured asset under Section 13(4) of the SARFAESI Act and sell secured asset without the interference of Courts or the DRT. Therefore, the remedy of the Tenants to approach the DRT's and to further to take it up in challenge in an appeal to the Appellate Tribunal, hardly provided any succour to the Banks, and defeated the very purpose and intention behind the enactment of SARFAESI Act.

THE JUDGMENT:

A recent judgment of the Supreme Court in Harsh Govardhan Sondagar v. International Assets Reconstruction Company Ltd., (2014) 6 SCC 1, has provided a shot in the arm to the Banks towards facilitating speedy recovery of their dues by paving way for the Banks to secure quick vacant possession of the property even by evicting certain kinds of Tenants. The Supreme Court held that the Bank could vacate (a) those Tenants whose leases/tenancies have expired or stood determined; or (b) those Tenants whose leases/tenancies are (i) contrary to Section 65A of the Transfer of Property Act, 1882 (the "TP Act") or (ii) contrary to the terms of the mortgage; or (iii) created after the issuance of notice of default and demand by the Bank under Section 13(2) of the SARFAESI Act. The judgment has been rendered at a time when there is mounting criticism on the loopholes in the SARFAESI Act that have been exploited by defaulters to the prejudice

of the Banks.

ANLYSIS OF THE JUDGMENT AND ITS IMPLICATIONS TO BANKS:

To understand the implications of the judgment it would be appropriate to classify the Tenants of secured assets into three types/categories.

1. A Tenant who was inducted into the property before it was mortgaged to the Bank.
2. A Tenant who was inducted into the property after it was mortgaged to the Bank but before the Bank issues notice of default and demands payment under Section 13(2) of the SARFAESI Act.
3. A Tenant who was inducted into the property after the Bank has issued a notice of default and made a demand for payment under Section 13(2) of the SARFAESI Act.

Category 1: As regards the 1st category i.e., a Tenant inducted prior to the mortgage, such lease/tenancy being prior to the mortgage, the Supreme Court has held that such lease/tenancy would be binding on the Bank, that the rights of the Banks under the SARFAESI Act cannot override the rights of the Tenants under the TP Act, and if the lease/tenancy is valid and subsisting and has not expired or been terminated at the time when the Bank seeks to take possession, then such Tenants cannot be dispossessed from the property/secured asset till their lease/tenancy rights expire or stand terminated as per law. It is to be noted that this does not mean that the Bank cannot proceed with the sale of the property but the sale would be subject to the rights of the Tenants and the Bank would not be able to hand over vacant possession of the property to the purchaser.

Even within this category, there could be Tenants whose lease/tenancy may have commenced before the mortgage but the lease/tenancy may have expired or may have been terminated as per law at the time when the Bank seeks to take possession. In such a case, the lease/tenancy rights having ceased, the Tenant could be evicted after obtaining an order from the Magistrate, who is required to give the parties proper notice and an opportunity of hearing.

It is not essential that the Borrower landlord himself must have terminated the lease if it has not expired. After the expiry of 60 days from the receipt by the Borrower of the demand notice under Section 13(2) of the SARFAESI Act, the Bank could take over the ownership rights of the Borrower landlord and hence even if there is a lease/tenancy created before the mortgage and has not expired, if the terms of the lease/tenancy permit the landlord to terminate the lease/tenancy under certain circumstances such as by simple notice of a particular period, or on default of rent etc., and if those circumstances avail, the Bank itself could issue a notice terminating the lease/tenancy as per the terms of the lease and then apply to the Magistrate and obtain orders for evicting the Tenant after Magistrate affords an opportunity of hearing to such Tenant. In this situation, the Bank could avoid going to a Civil Court and obtain a decree for possession. However, even in the above situation, if the tenancy is protected under the provisions of any Rent Control Statute and such statute provides for recovery of possession only by a special forum or court and only under certain circumstances, it would follow that such a Tenant cannot be evicted by the Magistrate at the instance of the Bank and such sale would be subject to the rights of the Tenant and the Bank would not be able to hand over vacant possession of the property to the purchaser.

Category 2: As regards the 2nd category, i.e., a Tenant inducted after the mortgage, here again, one could classify this lease/tenancy into three sub- categories:

A lease/tenancy which is in accordance with the provisions of Section 65A of the TP Act and not contrary to the terms of the mortgage;

A lease/tenancy which is contrary to the provisions of Section 65A of the TP Act;

A lease/tenancy contrary to the terms of the mortgage prohibiting the mortgagor/borrower from creating any tenancy or leasing of the property.

Section 65A of the TP Act provides that even when a property is mortgaged, the owner, if he is in possession, can execute a lease, provided that, a) it should be such as would be made in the ordinary course of management of the property, b) it should receive the best

rents that can be reasonably obtained, c) it should not stipulate for payment of any premium or payment of rent in advance, d) it should not have any covenant for the renewal of the lease, e) it should be ensured that such lease will take effect from a date within six months from the date of the lease, f) it should not be prohibited by the terms of the mortgage. Further in case of a building the landlord cannot lease it for more than three years.

As regards sub-category (i) above, i.e., Tenants inducted after the mortgage whose tenancy is not contrary to the terms of the mortgage or the provisions of S.65-A of the TP Act, the Supreme Court has held that these Tenants cannot be dispossessed from the property by the Banks unless their leases have expired or have got terminated as per the terms of the lease and if the Bank wishes to sell the property, it will obviously have to do so with Tenants in possession and subject to the lease/tenancy. The Supreme Court has also observed that for Tenants to claim a lease/tenancy for a period exceeding one year, they would have to produce a registered lease deed/ tenancy instrument as any lease/tenancy for a period exceeding one year can only be created by a registered document/instrument. Here again, provided that the tenancy is not protected under any Rent Control Statute, and if the terms of the lease permit termination by the landlord under certain circumstances and if those circumstances avail, after the expiry of 60 days from the receipt by the borrower of the demand notice under Section 13(2) of the SARFAESI Act, the Bank could take over the ownership rights of the borrower landlord and terminate the lease/tenancy as per the terms of such lease/tenancy and apply to the Magistrate and obtain orders for evicting the Tenant after Magistrate affords an opportunity of hearing to such Tenants.

As regards the sub-category (ii), a lease/tenancy created after the mortgage but not in accordance with, or contrary to the terms of Section 65A of the TP Act, for example, a lease/tenancy of a building for a term of more than three years or for lesser than market rent, such a lease/tenancy has been held by the Supreme Court to be invalid and hence in such a case, the Bank would be entitled to directly recover vacant possession by approaching the Magistrate. If

the Magistrate concludes after hearing the Tenants, that the lease/tenancy is contrary to the provisions of Section 65A of the TP Act, he can direct the Police authorities to provide assistance for taking possession of the property.

However it is likely that even in such cases the Tenants may contend that though their leases were initially void as being opposed to Section 65A of the TP Act, subsequently, by acceptance of rent by the landlord, a monthly lease/tenancy has resulted. To deal with such contentions, out of abundant caution, it would be advisable for the Banks after taking over the ownership rights under the SARFAESI Act to issue a notice to the Tenants, terminating the alleged lease/tenancy which may be claimed with a 15 days' advance notice being without prejudice to Bank's claim in the first place that there is no valid lease/tenancy at all.

As regards the Sub-category (iii), i.e., of Tenants inducted after the mortgage i.e., those inducted even though the terms of the mortgage prohibits tenancy or lease of property, yet again the Banks need not have the Tenants vacated by filing suits in the Civil Court but could have them evicted by approaching the Magistrate to seek recovery by dispossessing the alleged Tenants as their tenancies would also be invalid.

Category 3: As regards the third and the last category of Tenants i.e., those sought to be inducted by the landlord after the Bank has already issued notice under the SARFAESI Act demanding payment of dues and indicating that it would be enforcing on security under the provisions of SARFAESI Act, obviously such leases/tenancies would be invalid as the SARFAESI Act itself under Section 13(13) which prohibits any creation of encumbrance without prior consent after such notice by the Bank. Therefore, in such cases also the Banks need not have the Tenants vacated by filing a suit before the Civil Court nor are they constrained to sell the property with such Tenants in possession. The Bank can have such Tenants evicted and directly recover vacant possession under by approaching the Magistrate and have such Tenants vacated with the assistance of Police.

LEASES/TENANCIES PROTECTED UNDER RENT CONTROL

STATUTES:

The Supreme Court has not directly dealt with situations where leases/tenancies would be protected under any rent control statute. However it can be deduced that as regards leases/tenancies created prior to the mortgage if they are covered under Rent Control statutes then Banks may not be able to dispossess them under the provisions of the SARFAESI Act, unless those leases/tenancies have expired or stood terminated as per provisions of such rent control statute. To negate the cases of leases/tenancies created after the mortgage taking shelter under the provisions of any Rent Control Statute, the most advisable course for Banks is to ensure that the terms of the mortgage prohibit the creation of any such lease/tenancy. In such a case even if a lease/tenancy is created after the mortgage since it would violate the terms of the mortgage and be contrary to the provisions of Section 65A of the TP Act, the lease/tenancy would be invalid and may not qualify for protection under the Rent control statutes. Leases/Tenancies created after Bank having issued a notice of demand under Section 13(2) of the SARFAESI Act would also obviously be invalid as being against the provisions of the SARFAESI Act and would not qualify for protection under the Rent Control statutes.

The Supreme Court has also held that if a question arises as to under which category a Tenant would fall or whether the lease/tenancy has been created in violation of the provisions of Section 65A of the TP Act or not, or after the notice of demand under Section 13(2) of the SARFAESI Act or whether the lease/tenancy has stood determined, etc. all of such questions would be decided by the Magistrate himself under the provisions of the SARFAESI Act and once the decision is made by the Magistrate, that will be binding on the parties and the only remedy to challenge it is by way of a Writ Petition under the provisions of the Constitution of India. The Tenants will not have the option of approaching the DRT.

CONCLUSION:

This judgment certainly sets to rest controversies as to whether the Bank could get the Tenants also evicted under the provisions of the SARFAESI Act itself. It definitely strengthens the hands of the Banks

and protects them against sharp practices of the Borrowers trying to induct Tenants or create documents or ante dating documents showing a purported lease/tenancy merely with a view to impede vacant possession being taken and to depress the sale value. The judgment is noteworthy in that it has allowed eviction of Tenants under the SARFAESI Act even if they had been validly and legally inducted in the first place but if their leases/tenancies have expired or stood terminated by the time possession is sought to be taken by Banks. This may lead to a situation, where if leases/tenancies are validly created or subsisting, Banks may postpone their decision to take over possession or to sell the secured assets to wait for the time when leases/tenancies even if validly created will expire or be terminated, so that they could recover vacant possession and then get a better price in the sale of secured assets.

While on the one hand the above judgment certainly makes way for speedier recovery of possession from Tenants by the Banks, enables a better value to be obtained by sale of secured assets after recovery of vacant possession and this would be welcomed by the Banks, but from a purely legal perspective, it will have the effect of converting the Magistrate, normally a judicial officer meant to administer criminal cases virtually into a Civil Court by requiring to decide questions of civil character such as the nature of the lease/tenancy, whether it was one created before or after the mortgage, whether the lease/tenancy has expired or properly terminated, whether the leases were created after the mortgage and without being against the terms of the mortgage, whether the property fetches a proper rent or it is in the ordinary course of management of the property etc. The consequence of the Magistrate being rendered virtually into a Civil Court is certainly startling and one which perhaps may not have been contemplated by the Parliament itself when it enacted the SARFAESI Act. However, the Banks will certainly not be complaining.