Critical analysis of decision in *MARDIA CHEMICALS LTD V/s UNION OF INDIA & OTHERS* in strengthening of Creditors Protection Regime in India

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"It is emphatically the province of courts to say what the law is"

-Justice John Marshal in Marbury vs Maddisson[1]

1. Introduction

Courts are the sovereign and authoritative interpreter of the statutes and they put life and blood in the skeleton of the statute by interpreting what is the *sentential legis* i.e. intention of the legislators . It is essential to know the precedent setting judicial decisions for critical and comprehensive understanding of what the law is. It is therefore pertinent to examine principles evolved through judicial decisions protecting the rights of both Secured Creditor and Borrowers. The apex court ruling in *Mardia Chemicals Ltd V Union of India*[2] is one such precedent setting judicial decision. It may be apt to say that what the decision in *Keshavananda Bharati* [3] is to the Basic Structure Doctrine, the same is the decision in *Mardia Chemicals* is to strengthening of Creditors Protection Regime in India. Therefore it is worth examining the contribution of *Mardia Chemicals* ruling in strengthening the Creditors Protection Regime in India.

2. Landmark Principles evolved through judicial decisions prior to *Mardia Chemicals* ruling

Law evolves over a period, through judicial decisions, therefore it is pertinent to appreciate the law evolved through judicial decisions in order to critically examine the contribution of *Mardia Chemicals* ruling in strengthening the Creditors Protection Regime in India.

1. Secured Creditors can stand outside winding up proceedings and realize security without consent of company court.[4]

2. Secured Creditor standing outside winding up proceedings has no right to claim any dividend out of money realized by a creditor proceeding under recovery law. In order to be entitled to dividends-he must relinquish his security and participate in winding up proceedings.[5]

[1] 5 U.S. (I Cranch) 137, 177 (1803).
[2] 2004 (4) SCC 311
[3] *AIR 1973 SC 1461*
[4] M.K.Rangnathan & another v. Government of Madras and others, AIR 1955 SC 604

3. Surety cannot restrain execution against him on the ground that first Secured Creditor should proceed against Borrowers. [6]

4. Supreme court observed that it is absolutely unfair to auction all the property of the borrower when some part of it is sufficient to meet the debt dues.[7]

5. Supreme Court laid down that Secured Creditor should act in fair and reasonable manner. Banks and Financial Institutions need to exercise right to recovery without intervention of courts with care and caution and ensure that every authorized officer exercising such power exercises it in fair and reasonable manner.[8]

6. Financial Corporations are not sitting on king Solomon's mines but they too borrow money from government or other financial corporations and they also have to pay interest thereon. Fairness is not a one-way street and the fairness required of the corporation cannot be carried to the extent of disabling it from what is due to it. While not insisting on the borrower to honour the commitments undertaken by him, corporation cannot be shackled hand and foot in the name of fairness.[9]

7. It will be necessary to hear borrower before taking over management of business of the borrower.[10]

8. Borrower cannot be arrested and detained in prison on the ground of inability to pay debts.[11]

9. It is clear from these rulings that in the Pre-SARFAESI stage that the principles of Creditors Protection and Borrowers Rights evolved through judicial decisions were well entrenched.

3. Constitutional validity of SARFAESI Act 2002

It is necessary to examine and understand the constitutional vires of a statute as the constitution is the Highest and Supreme Law of the land. A constitutionally bad law cannot confer any substantive rights or impose any legal obligations. As no statute can be constitutionally ultra-vires, it is pertinent to examine the landmark judicial decisions on constitutionality of SARFAESI Act 2002. In *Mardia Chemicals Ltd V Union of India,* the Hon'ble Supreme Court of India held that the provisions of the SARFAESI Act 2002 are valid except sub-section (2) of section 17, which is ultravires of Article 14 of the Constitution of

[5] Allhabad Bank v. Canara Bank & Another, AIR 2002 SC 1535
[6] Bank of Bihar v. Damodar Prasad , AIR 1969 SC 297.
[7] Ambati Narsayya v. M.Subba Rao & another, AIR 1990 SC 119
[8] Mahesh Chandra v. Regional Manager UP Financial Corporation & others, (1993) 2 SCC 299
[9] U.P.Financial Corporation v. Gem Cap (India)(p) Ltd. , (1993) 2 SCC 279
[10] Swadeshi Cotton Mills v. Union of India, AIR 1981 SC 818
[11]Jolly George Verghese & Anr v. The Bank Of Cochin, 1980 AIR 470

India. The very intention of strengthening Creditors Protection Regime was judicially scrutinized on the touchstone of the Constitution.

Contentions of the Petitioner - Borrower	**Contentions of the Respondent - Banks**
1. Arbitrary powers are conferred on secured creditors, 2. No appropriate and adequate mechanism to dispute the correctness of the demand, its validity and the actual amount of the dues, sought to be recovered, 3. No provision of Natural Justice Principle of hearing to the borrower is contained, 4. There is already RDDBFI Act 1993 meant for recovery of dues, **5.** Condition for 75% pre-deposit in appeal is unreasonable and violative of Article 14.	1. Objective of Act is reducing NPA in the interest of economy, 2. Swift law for enforcement of security interest is essential, 3. Borrower has opportunity to take objection after receipt of notice, 4. Pre-deposit of 75% is not a mandatory condition and it may be waived, 5. Ouster of civil courts jurisdiction was necessary as valuable time and resources are wasted due to judicial delays.

4. The principles laid down in Mardia Chemicals case were-

1. Though the transaction may have a character of a private contract yet the question of great importance behind such transaction as a whole having far reaching effect on the economy of the country cannot be ignored, purely restricting it to individual transactions more particularly when financing is through banks and financial institutions utilizing the public money.

2. The unrealized dues of banking companies and financial institutions utilizing public money for advances were mounting and it was considered imperative in view of recommendations of experts committees to have such law which may provide speedier remedy before any major fiscal set back occurs. Such legislation would be in the public interest and the individual interest shall be subservient to it.

3. Wherever public interest to such a large extent is involved and it may become necessary to achieve an object which serves the public purposes, individual rights may have to give way. Public interest has always been considered to be above the private interest.

4. The interest of individual may, to some extent, be affected but it cannot have the potential of taking over the public interest having an impact in the socio-economic drive of the country. There have been

many instances where existing rights of the individuals have been affected by legislative measures taken in public interest. Even if a few borrowers are affected here and there, that would not impinge upon the validity of the Act which otherwise serves the larger interest.

5. In the present day of global economy it may be difficult to stick to old and conventional methods of financing and recovery of dues. Hence, it cannot be said that a step taken to evolve means for faster recovery of the NPA's was not called for. Considering the totality of circumstances the financial climate world over, if it was thought as a matter of policy, to have yet speedier legal method to recover the dues, such a policy decision cannot be faulted with nor it is a matter to be gone into by the Courts to test the legitimacy of such a measure relating to financial policy.

6. As the terms and conditions and circumstances in which the debt is to be classified as non-performing asset has been laid down by the Reserve Bank of India, there is no substance in the submission that there are no guidelines for treating the debt as a non-performing asset.

7. On measures having been taken under sub-section (4) of section 13 and before the date of sale /auction of the property it would be open for the borrower to file an appeal under Section 17 of SARFAESI Act 2002 before the Debt Recovery Tribunal. After service of 13(2) notice, if the borrower raises any objection or places facts for consideration of the secured creditor, such reply to the notice must be considered with due application of mind and the reasons for not accepting the objections, however brief they may be, must be communicated to the borrower.

8. The amount of deposit of 75 per cent of the demand, at the initial proceedings itself, sounds unreasonable and oppressive. Requirement of deposit of such a heavy amount on basis of one sided claim alone, cannot be said to be a reasonable condition at the first instance itself before start of adjudication of the dispute. Merely giving power to the Tribunal to waive or reduce the amount, does not cure the inherent infirmity leaning one-sidedly in favour of the party, who, so far has alone been the party to decide the amount and the fact of default and classifying the dues a NPAs without participation/association of the borrower in the process.

5. Conclusions about the Contribution of the decision in Mardia Chemicals Case in strengthening Creditors Protection Regime in India :

The SARFAESI Act was amended with effect from 11.11.2004 in the light of the observations of the Hon'ble Supreme Court in Mardia Chemicals Case and the following major amendments to the Act were carried out –

1. Section 3-A was inserted providing for an opportunity to the borrower to make representation or raise objections against the demand notice issued under sub-section (2) of Section 13 and disposal of such representation within one week from the date of its receipt. A proviso was inserted that the reasons communicated to the borrower in response to the representation shall not confer any right upon him to prefer an application to the Debt Recovery Tribunal.

2. Sub-section (2) of Section 17 which provided that the appeal filed by the Borrower against the measures taken by the secured creditor under sub-section (4) of section 13 shall not be entertained unless the borrower deposited with the Debt Recovery Tribunal 75% of the amount claimed under demand notice with a proviso that the Debts Recovery Tribunal may waive or reduce the amount for reasons to be recorded in writing have been substituted with the provision that the Debt Recovery Tribunal shall consider whether any of the measures referred in sub-section (4) of section 13 taken by the secured creditor are in accordance with the provisions of the Act and rules made there under.

3. The provision of Appeal to the Appellate Tribunal under section 18 were also modified and it was provided that the appellate tribunal shall not entertain any appeal against the Order made by the Debts Recovery Tribunal under section 17, unless 50% of the amount of debt due is deposited with the Appellate Tribunal with a proviso that the Appellate Tribunal is vested with the discretion to reduce the amount to not less than 25% of the debt.

4. The Recovery of Debts Due to Banks and Financial Institutions Act was also amended to include a proviso to section 19 (1) to the effect that the bank or financial institution may, with the permission of the Debts Recovery Tribunal, withdraw the application whether made before or after the Enforcement of Security Interest and Recovery of Debt Laws (Amendment) Act, 2004 for the purposes of taking action under the SARFAESI Act.

Therefore, it may be concluded that, what the decision in *Keshavananda Bharati* [12]is to the Basic Structure Doctrine, the same is the decision in *Mardia Chemicals* is to strengthening of Creditors Protection Regime in India.

[12] Supra Note 3