THE HARSHAD GOVARDHAN CASE: PERFORMING THE BALANCING ACT

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ABSTRACT

This paper deals with two aspects, firstly the Front Running in Indian context and secondly, an analysis of Insider Trading with respect to the Section 195 of Indian Companies Act, 2013 and the new Security Exchange Board of India (SEBI) Regulation in Prohibition of Insider Trading 2015; and also deals with the new term 'proposed to be listed' as mentioned in the SEBI Regulation on Prohibition of Insider Trading 2015. Insider trading and Front Running are both confused terms and are often confused and mixed with each other. In the eyes of law, both are at divided terms. Both insider trading and front running are criminal offences though, the latter may not be a criminal offence at certain times, which depends upon the situations prevailing at that time and the laws of the country. Front Running is an investment game or a strategy based on the move of the clients wants to buy a certain stock of the company. It anticipates the impact of the up upcoming value of trades. In India, SEBI through its regulations has made the act of trading using the stock information of their own clients in the share

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market illegal. Whereas, Insider Trading is a concept where a person who is well versed with the company, uses his position to secretly make profits from the knowhow and the knowledge. This will affect the markets and will induce unfair advantage to the insider who used the information of the company.

There is also a conflict between the SEBI Regulations on Prohibition of Insider 2015 and the Section 195 of the Companies Act, 2013. The SEBI Regulations 2015, has liberalised the penal system with respect to penalising the Insider whereas the Companies Act, 2013 uses a narrow approach for the same. An ambiguity also exists when it comes to application of this regulation on 'proposed to be listed companies'.

I. INTRODUCTION

The banking sector is the foundation of every monetized economy in the world and forms the core of the financial sector of an economy. In the post liberalisation era, the Indian banking system has undergone significant transformation following financial sector reforms with an aim to adopt international practices and improve the efficiency of the sector.[1] However, one of the major roadblocks of the Indian banking sector has been its inability to tackle the rapid growth of non-performing assets (NPAs). The proliferation of NPAs has led to inefficiency in the sector by virtue of reduced profit earning capacity of the banks. It has also imposed hidden costs such as cost of legal action for recovery of amount etc. on the banks.

[1]Pacha Malyadri & S. Sirisha, *A Comparative Study of Non-Performing Assets in Indian Banking Industry*, 1(2) INT'L J. OF ECON. PRACTICES & THEORIES 77 (2011).

Over the years, various committees have been appointed to review the banking sector in India and suggest possible means to make it more robust and efficient so as to combat the menace of NPAs. Various legislations have been enacted to give effect to their recommendations. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (hereinafter referred to as the "**SARFAESI Act, 2002**") is one such legislation with its object being to regulate securitization and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto.[2] The Act enables and empowers the secured creditors to take possession of their securities, to deal with them without the intervention of the court[3] and also to authorize any Securitization or Reconstruction Company to acquire financial assets of any Bank or Financial Institution.[4]

Though the purpose of the Act was to ensure speedy recovery of dues without judicial intervention[5], the Act has been subject to widespread criticism in that it vests unqualified power with the creditors leaving the debtors with little safeguards. The Act has also been denounced for being silent on various aspects and having many loopholes which are exploited both by creditors and borrowers alike. One such issue which has recently come into the limelight pertains to the rights of tenants in a mortgaged property and its implications on the secured creditor's right of enforcement of security interest under the Act. Since the provisions of the Act are silent on this aspect, there have been numerous judgments from different High Courts in this regard.[6]

[2]SARFAESI Act, 2002, Preamble.
[3]M/S Lakshmi Shankar Mills (P) Ltd v. The Authorised Officer/Chief, AIR 2008 Mad 44.
[4]Paam Pharmaceuticals (India) v. India Sme Asset Reconstruction, 2012 VAD Delhi 15.
[5]United Bank of India v. Satyawati Tandon, 2010 9 SCR 1.
[6]*See* N.P. Pushpangadan & Ors. v. Federal Bank & Ors., AIR 2012 Ker 27; Hutchison Essar South Ltd. v. Union Bank of India, AIR 2008 Kant 14; Trade Well v. Indian Bank, 2007 CriLJ 2544.

Each High Court has taken a diverse position by interpreting and applying the law distinctly. In the landmark case of Harshad Govardhan Sondagar v. International Assets Reconstruction Co. Ltd.,[7] the Supreme Court has put to rest conflicting views of various High Courts regarding different issues involving the rights of the tenants and the remedies available to them when the secured creditors exercise their rights under the provisions of the Act.

II. THE HARSHAD GOVARDHAN SONDAGAR CASE

A. Facts

A group of banks advanced loans to the borrowers and certain premises were kept as securities for the mortgage. When the borrowers defaulted on these loans, the secured creditors classified their accounts as non-performing assets. They were also issued notices under section 13(2)[8] of the Act, giving the borrowers a time period of 60 days to repay their debts. The borrowers failed to repay the debts within 60 days and the secured creditors exercised their right under section 13(4)[9] of the Act to take possession of the borrowers' secured assets. To take possession of the premises, they also filed an assistance application before the Chief Metropolitan

[7]Harshad Govardhan Sondagar v. International Assets Reconstruction Co. Ltd. & Ors., (2014) 6 SCC 1.

[8]SARFAESI Act, 2002, § 13 (2). The provisions read as: Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub- section (4).

[9]SARFAESI Act, 2002, § 13 (4). The provisions read as: In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:-

(a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

Magistrate of Mumbai, under section 14(1).[10] But, some people claimed to be the *bona fide* tenants of these properties, and threatened by eviction by the Chief Metropolitan Magistrate, they approached the Bombay High Court.

The petition of the tenants was dismissed by placing reliance on the case of *Trade Well. v. Indian Bank,*[11] wherein a division bench of the Bombay High Court had held that on account of failure of the borrower to repay his liability, when a secured creditor initiates measures under section 13(4) of the Act and approaches the Chief Metropolitan Magistrate for assistance to take possession of the secured assets under section 14, the liability of the borrower crystallizes, and there can be no adjudication by the Chief Metropolitan Magistrate and possession has to be taken by a non-adjudicatory process. At this stage, there is no question of pointing out to the Chief Metropolitan Magistrate that the person who is to be dispossessed is a tenant or not. Aggrieved by this judgment, the tenants filed a Special leave Petition under Article 136 in the Supreme Court.

B. The Decision

The main observations of the Apex Court were:[12]

1. Where the lawful possession of the secured

[10]SARFAESI Act, 2002, § 14 (1). The provisions read as: Where the possession of any secured assets is required to be taken by the secured creditor or if any of the secured asset is required to be sold or transferred by the secured creditor under the provisions of this Act, the secured creditor may, for the purpose of taking possession or control of any such secured asset, request, in writing, the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction any such secured asset or other documents relating thereto may be situated or found, to take possession thereof, and the Chief Metropolitan Magistrate or, as the case may be, the District Magistrate shall, on such request being made to him—
(a) take possession of such asset and documents relating thereto; and
(b) forward such assets and documents to the secured creditor.

[11]Trade Well v. Indian Bank, 2007 Cri. L.J. 2544.

[12]Harshad Govardhan Sondagar v. International Assets Reconstruction Co. Ltd. (2014) 6 SCC 1.

asset is not with the borrower, but with the lessee under a valid lease, the secured creditor cannot take over possession of the secured asset until the lawful possession of the lessee gets "*determined*".

2. However, section 13(4) of the SARFAESI Act does not mention that a lease made by the borrower in favour of a lessee will stand determined when the secured creditor decides to take any action under in section 13 of the Act.

The Supreme Court formed 3 categories of tenants in this case: -

1. *Where lease is created by the owner before mortgage of the immovable property*

When before the creation of mortgage, if the property is rented or leased out by the owner or a person competent to do so, the tenant or the lessee will have the right to enjoy the leased property in accordance with the terms and conditions of the original lease, irrespective of whether a subsequent mortgagee of the immovable property or the Bank has knowledge of such a lease or not.[13]

However, by virtue of section 13(4)(d)[14] of the Act, the secured creditor has the right to receive any money due or which may become due, which includes rent payable to the borrower by the lessee.

2. Where lease is created by the owner after mortgage of the immovable property

The owner's power to rent out or lease his immovable property comes from section 65A(1)[15] of the Transfer of Property Act, 1882. This can be exercised as long as he is in lawful possession of the property, pursuant to section 65A(2) of the Transfer of Property Act, 1882. Such a lease agreement is binding on the mortgagee or the Bank.

[13]*Id.*
[14]See, SARFAESI Act, 2002,§ 13(4).
[15]See, Transfer of Property Act, 1882, § 65A (1).

Only after the lease stands determined, under the relevant provisions of section 111 of the Transfer of Property Act, 1882, can the secured creditor proceed against the mortgaged property, for possession etc. It is pertinent to note that a lease doesn't automatically get determined when the secured creditor initiates action under section 13 of the Transfer of Property Act, 1882. However, section 65A(3)[16] of the Transfer of Property Act, 1882, further provides that the mortgagor has the power to rent out or lease his immovable property, as long as a contrary intention is not expressed in the mortgage-deed.

3. Where lease created by the owner after receiving notice under section 13(2).

Section 13(13) of the Act, provides that after receipt of notice pursuant to section 13(2) of the Act, none of the secured assets referred to in the notice, shall be leased or sold by the borrower, without the prior written consent of the secured creditor.[17]

By virtue of section 35 of the Act, section 13(13) overrides the provisions of section 65A of the Transfer of Property Act, 1882 and a lease of a secured asset made by the borrower, after he receives the notice under section 13(2) from the secured creditor intending to enforce that secured asset, will not be a valid lease. This position was reiterated by the Madras High Court in the recent case of Hairoonthai Public School v. The District Collector-cum-Magistrate and Ors.[18]

Hence, in such cases, where the lease is created after receiving the notice under section 13(2), the secured creditor may take over possession of the property from the lessee, as the lease is invalid and void.

[16]See Transfer of Property Act, 1882, § 65A (3).
[17]SARFAESI Act, 2002, §13 (13).
[18]Hairoonthai Public School v. The District Collector-cum-Magistrate and Ors, W.P.No. 6857 of 2015 (Mad.).

The Supreme Court has also held that the Magistrate himself would decide questions like under which category a Tenant falls, or whether the lease/tenancy has been created after the notice under section 13(2) of the Act or whether the lease/tenancy has stood determined according to section 111 of the Transfer of Property Act, 1882 etc. The Magistrate's decision will be binding on the parties and the only remedy for a tenant is to challenge it through a Writ Petition. The Tenants cannot approach the DRT regarding these.

III. ISSUES IN CONTEMPORARY SCENARIO

A. Enlargement of powers of magistrate under Sec. 14

The Supreme Court in the Harshad Govardhan case held that under section 14, the Chief Metropolitan Magistrate or District Magistrate will have to deal with questions such as – whether the lease under which the lessee claims to be in possession of the secured asset stands determined in accordance with section 111 of the Transfer of Property Act[19], whether it was one created before or after the mortgage, whether the leases were created after the mortgage and without being against the terms of the mortgage etc. Thus, the effect of the judgment is that what was otherwise a non-adjudicatory process would now partake the character of a quasi-judicial proceeding. [20] This enlargement of powers of the Chief Metropolitan Magistrate or District Magistrate under section 14 poses some difficulty. Section 14(1A) of the Act states that a Chief Metropolitan Magistrate or District Magistrate may delegate his work to a sub-ordinate officer[21] which goes on to show that the Parliament only intended to vest administrative powers with the concerned authorities under the

[19]*Supra* note, 10.
[20]M/S. Vision Comptech Integrators v. State Bank Of India &Ors, AIR 2014 Cal 161.
[21]SARFAESI Act, 2002, § 14(1A).

section 14. It is a well settled position of law that though sub delegation of administrative functions is permissible, sub delegation of quasi-judicial functions is impermissible. The apex court has held in numerous instances that there shall be no delegation of judicial or quasi-judicial powers except in cases where there is specific authorisation. Such powers shall not be capable of sub-delegation even if the statute authorises that."[22] So, on a combined reading of the Harshadgovardhan case and section 14(1A), the impression generated is that section 14 of the Act permits delegation of quasi-judicial functions. Though the Supreme Court had the best intentions while delivering the judgment, the interpretation of the Court can potentially lead to a challenge on the constitutional validity of section 14. Therefore, in light of the supposed anomaly, the Parliament should take pre-emptive measures and make suitable amendments in the Act to bring it in conformity with the decision of the Harshad Govardhan case in this regard.

Another criticism is that from a purely legal perspective, the judgment will have the effect of virtually transforming the Chief Metropolitan Magistrate or District Magistrate into a civil court which goes against the provisions of the Civil Procedure Code, 1908 as it grants no power to a Chief Metropolitan Magistrate or District Magistrate to entertain matters of civil nature. However, such criticism is mostly unfounded as the scope of the function of the authorities is merely extended to quasi-judicial functions and not judicial functions.

B. Remedy from order of magistrate

Since the provisions of the Act are silent about the creation of a tenancy in a secured asset, the remedy available to the tenant in case of wrongful action taken by the secured creditor has been a contentious issue. In case the tenants resist attempts of secured

[22]Regional Director, E.S.I. Corpn. v. Bhaskaran, ILR 1986 (2) Kerala 524.

creditor to take possession of the secured asset, the secured creditor may file an application under section 14 of the Act. Here, the topic of controversy is whether the remedy from the order of the magistrate lies in front of the DRT under section 17 or in the form of writ under Article 226 before a High Court.

According to the ruling in the Harshad Govardhan case, it was held that the only remedy available to a tenant aggrieved by an order under section 14 was to file a writ under Article 226 before a High Court. The reasoning given was that though a lessee could file an application as an aggrieved under section 17(1)[23], the DRT did not have powers to restore possession to the lessee because section 17(3)[24] only enables the DRT to restore possession to the borrower and not to any other person. Thus, in effect no remedy was available to the lessee under section 17. On the contrary, it held that though section 14(3) of the Act makes the order of the Chief Metropolitan Magistrate or District Magistrate final, a statutory provision could not take away a power vested by the Constitution[25]. Therefore, any party aggrieved of the order under section 14 could challenge the order under Article 226 of the Constitution.

However, there is an alternate view. Section 17(1) of the Act affords a right to any person who is aggrieved by any of the measures taken by the secured creditor or his authorised officer under section 13(4) to make an application before the DRT. The expression "*any person*" used in section 17(1) is of wide import. It takes within its fold, not only the borrower but also the guarantor or any other person who may be affected by the action taken under section 13(4) or section 14.[26] Here, it is to be noted that section 14 is merely a continuation of the procedure under section 13 and is on that account impliedly covered

[23]See, SARFAESI Act, 2002, § 17(1).
[24]See, SARFAESI Act, 2002, § 17(3).
[25]Columbia Sportswear Company v. Director of Income Tax, Bangalore, (2012) 11 SCC 224.
[26]United Bank of India v. Satyawati Tondon (2010) 8 SCC 110.

under section 17. When an application is made under section 17 of the Act by a person claiming to be a tenant under the borrower or any person under whom the borrower claims title, the DRT has jurisdiction to entertain the application and to enquire into the question as to whether the applicant had any right, title or interest or possession anterior to the creation of the security interest and to what extent such interest could be protected.[27] The Madras High Court has made similar observations on this issue.[28] Further, a combined reading of section 17, section 34[29] and section 35[30] implies that the tenant, if aggrieved by the coercive measures taken by the respondent bank under section 13(4) of the said Act, has the remedy to apply before the DRT.[31]

Further, the fact that specific mention is made for restoration of possession in favour of the borrower does not mean that restoration of possession in favour of a person other than the borrower is impossible while passing an order under section 17(3).[32] The expressions "*pass such order as it may consider appropriate and necessary*" in section 17(3) clearly indicates that the DRT' has ample powers to deal with any situation where a recourse taken by the secured creditor under section 13(4) is invalid.[33]

It is submitted that the latter view seems to be more appropriate in light of the objective of establishing DRTs, which was to have a specialised forum for expeditious recovery of debts.[34] Also, a

[27]N.P. Pushpangadan & Ors. v. Federal Bank & Ors, AIR 2012 Ker 27.
[28]Sree Lakshmi Products v. State Bank Of India, AIR 2007 Mad 148.
[29]Civil Court not to have jurisdiction. See, SARFAESI Act, 2002, § 34.
[30]The provisions of this Act to override other laws. See, SARFAESI Act, 2002, § 35.
[31]Om Prakash Shukla v. State Bank of Bikaner and Jaipur, S.B. CIVIL W.P. NO. 999/2011 (Raj.).
[32]Fakrudheen Haji V.P. v. State Bank of India, ILR 2009 (1) Ker. 357.
[33]*Id.*
[34]Tripathi, Shivnath, *Debt Recovery Tribunal Vis a Vis Civil Court* (April 17, 2013), http://dx.doi.org/10.2139/ssrn.2281384

combined reading of section 17(1) and 17(3) leads us to believe that section 17(3) is clearly an instance of casus omissus. A Casus Omissus literally means case omitted. It is basically a situation not provided for by a statute or contract and therefore governed by case law or new-judge made law.[35] Thus, the gap in the provision may be filled by the courts by interpreting the expression "*pass such order as it may consider appropriate and necessary*" to include restoration of possession to tenants. Though it may be argued that doing so would frustrate the objectives of the Act which was to reduce intervention of courts, it must be borne in mind that the case of tenants is a special one and he/she must be given adequate protection under the law.

IV. CONCLUSION

The SARFAESI Act, 2002 is a piece of legislation fraught with several gaps which constantly keep on coming up before the courts as a subject matter of interpretation. One of the issues which has recently gained prominence is the status of tenancy created in mortgaged properties. The Supreme Court in the Harshad Govardhan case has brought in much needed clarity in this aspect by clearly laying down the conditions in which a secured creditor cannot dispossess a tenant from the secured asset. Though the decision may prima facie appear to defeat the objectives of the Act, the Supreme Court has taken an even handed approach and tried to bring the creditors and borrowers on a level playing field through this decision. While the ruling has authoritatively laid down the law in various aspects such as requirement of principles of natural justice, categories of tenants who can avail protection etc., the court might have inadvertently created certain absurdities in the law which needs to be addressed. The court's decision is irreconcilable with certain provisions of the Act and is also inappropriate when it comes to the forum of appeal from

[35] BRYAN A. GARNER, BLACK'S LAW DICTIONARY 247 (9TH ED. W. PUBL'G CO 2009).

an order of the Magistrate under section 14. However, on the whole, the decision can undoubtedly be considered as a progressive step towards interpretation of a legislation which has faced scathing criticism for being unduly tilted towards the creditors.