



# Rights of Secured Creditors under SARFAESI – How protected are the rights?



Nikita Chawla  
Sr. Associate

[nikita.chawla@jclcx.com](mailto:nikita.chawla@jclcx.com)



Sameer Bindra  
Associate

[sameer.bindra@jclcx.com](mailto:sameer.bindra@jclcx.com)

One of the biggest issues that continues to stress the banking sector as of date is the mounting number of non performing assets. The federal legislation enacted in 2002, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI Act**") has been in force for more than a decade. It was enacted with the intent to help financial markets improve recovery by exercising self-help powers to take possession of and enforce collateral. In other words, to reduce non-performing assets by adopting measures for recovery.

Some of the impediments in enforcing creditors rights have been local laws/state level legislations as different from federal/union laws. So what would be the outcome in such a situation? Will the rights of the secured creditors continue to be protected or will the state level legislations impact such rights? Will the federal level legislation prevail or the state level legislation?

These questions have been addressed in the recent pronouncements of Indian courts including the Supreme Court of India ("**Supreme Court**"). Two recent judgements have dealt with the debate in relation to supremacy of central legislations over state legislations. Having regard to the constitutional principles which visualise a federal structure, where the Union Parliament is given full independence and so are the State Legislatures

(in their respective fields of lawmaking), the courts have held that the provisions of SARFAESI Act will prevail over the state legislations.

### **SARFAESI Act vs State Legislations**

Protecting the interest of secured creditors and reiterating the constitutional principle of federal supremacy<sup>1</sup> in relation to the SARFAESI Act, was upheld in *JM Financial Asset Reconstruction Company Pvt. Ltd. vs. State of Maharashtra and Ors.*, the Bombay High Court ("**Bombay HC**") held that actions taken under the SARFAESI Act shall have a prevailing effect over the provisions of any notifications issued under the Maharashtra Relief Undertaking Act, 1948 ("**MRU**"). The Bombay HC observed that the MRU was enacted under the concurrent list<sup>2</sup> under the Constitution while the SARFAESI Act was enacted under the Union list. By virtue of the non-obstante clause<sup>3</sup> in Article 246(1), the Bombay HC held that the central legislation will prevail. Thus, a secured creditor can exercise his/her rights under the SARFAESI Act notwithstanding the notifications issued under the MRU, which otherwise suspended enforcement of rights against a 'relief undertaking'.

Subsequently, in the matter of *UCO Bank v. Dipak Debbarma*<sup>4</sup>, the Supreme Court also ruled in favour of the bank which was a secured creditor under the SARFAESI Act. The legislation in this case was the Tripura Land Revenue and

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<sup>1</sup> The Constitution of India ("**Constitution**") declares distinct powers which are enjoyed by the State and the Parliament. This is enumerated in the Seventh Schedule of the Constitution. In case there is an impingement by either the State or the Parliament during the enactment of a legislation, the Constitution has set out the procedure which is to be followed in Articles 246 and 254. These articles, in essence state, that the Central legislation will prevail over State legislation. However, there are exceptions to this rule.

<sup>2</sup> Under the concurrent list, both the Central and the State legislature have power to make laws.

<sup>3</sup> A non-obstante clause is one which has the words "*notwithstanding any...*" i.e. it makes the provision independent of other provisions contained in the law, even if the other provisions provide to the contrary

<sup>4</sup> 2016 SCC OnLine SC 1391

Land Reforms Act, 1960 ("Tripura Act"). Section 187 of the Tripura Act, which stipulates a judicial restriction on sale of the immovable properties to any person who is not a member of a scheduled tribe. Irrespective of such a restriction, the Supreme Court in this judgment held that, the sale notification, which had been issued by the bank under the provisions of the SARFAESI Act was valid, even though it was purportedly in contravention of the Tripura Act. This is on the basis that the mortgaged property was intended to be sold by the bank to a third party which was not a member of the scheduled tribe. The Supreme Court further stated that when the Parliament enacted a legislation for enforcement of security interest i.e. SARFAESI Act, which deals exclusively with sale of secured assets, the Tripura Act, to the extent that it is

inconsistent with the SARFAESI Act, must give way.

### To Conclude...

These judgments address the question of primacy of a federal legislation over local/state laws in particular, of the SARFAESI Act. In every situation where there is ambiguity in terms of overriding powers between 2 (two) statutes, the intent of the legislation will need to be looked into, which in these cases dealt with the protection and enforcement of rights of secured creditors. The judicial pronouncements will assist such creditors to enforce their rights without much hiccups, however, hiccups will continue and exceptions to the rule will exist. Which legislation becomes the next exemption, only time and the next judicial pronouncement can tell..

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## Contact us:

### MUMBAI OFFICES

#### Corporate Office

902, Tower 2, Indiabulls Finance Centre,  
S. B. Marg, Elphinstone Road (West),

**Mumbai** – 400 013, India

Tel: +91 22 6720 5555 / +91 22 4057 5555

Fax: +91 22 2421 2547

#### Dispute Resolution Office

802, Raheja Chambers, Free Press Journal Marg,  
Nariman Point,

**Mumbai** – 400 021, India

Tel.: +91 22 4920 5555

Fax: +91 22 2204 3579

### DELHI OFFICE

H-17, Lower Ground Floor, Kailash Colony,

**New Delhi** - 110 048, India

Tel: +91 11 4175 1889

Fax: +91 11 4108 4175

### BENGALURU OFFICE

Kheny Chambers, Upper Ground Floor,

4/2 Cunningham Road,

**Bengaluru** – 560 052, India

Tel: +91 80 4669 8200

Fax: +91 80 2226 6990

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