

"As Is Where Is Basis"- Judicial Interpretation under SARFAESI Act, 2002

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Secured creditor shall recover the debt by way of sale under Section 13 (4) of SARFAESI Act, 2002. Generally the assets are sold on "as is where is" and as is what is" basis and while effecting sale by inviting tender from public or holding public action, the details of the encumbrance known to the secure creditor are declared/furnished to the public at large. While interpreting Rule 8(6) of Security Interest (Enforcement) Rule, 2002, the Bank/Financial Institution is imposed with the accountability to conduct due diligence/make thorough search on the assets before the sale. The plea of ignorance of the knowledge of encumbrance on the assets sold on the pretext of "as is where is" is no longer an acceptable argument in the light of the judicial interpretation.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) is enacted to provide a speedy and summary remedy for recovery of thousand of crores which are due to the Bank. In other words, the Act enables the bank and FI to realise long-term assets, manage problems of liquidity, asset liability mis-match and to improve recovery of debt by exercising powers to take possession of securities, sell them and thereby reduce non-performing assets by adopting and re-construction. The Bank/FI is entitled to take actual possession of the secured assets from the borrower or from any other person in terms of Section 13(4) of the SARFAESI Act . Any transfer of secured assets after taking possession of the same by the Bank/FI shall vest in the transferee all rights in relation to the secured assets as if the transfer has been made by the owner of such secured assets. Section 17(1) of the SARFAESI Act provides for appeal remedy to the aggrieved parties of any of the measures resorted to by the Bank under Section 13(4) of SARFAESI Act. If the party dispossessed is not in accordance with the provision of the Act, then the DRT is entitled to put the clock back by restoring the status *quo ante*.¹ These are the broad guidelines under which the secured assets are enforced/realised and the Bank/FI are able to recover its money against the secured assets in shortest time frame.

Where any borrower , who is under a liability to a secured creditor , makes any default in repayment of secured debt or any installment thereof , and his account in respect of such debt is classified by the secured creditor as non-performing asset, then the secured creditor may issue notice to the borrower 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) which shall included "Sale" under Section 13(4)(a).

As per Rule 8(5) of the Security Interest (Enforcement) Rule, 2002 , the methods of sale of the immovable secured assets include:

- (a) by obtaining quotations from the persons dealing with similar secured assets or otherwise interested in buying the such assets; or
- (b) by inviting tenders from the public;
- (c) by holding public auction; or
- (d) by private treaty.

The relevant provision of Rule 8(6) of the Security Interest (Enforcement) Rules, 2002 which deals with the procedure for bringing the immovable secured assets for sale is extracted hereunder:

“The authorised officer shall serve to the borrower a notice of thirty days for sale of the immovable assets under sub-rule (5):

Provided that if the sale of such secured asset is being effected by either inviting tenders from the public or by holding public auction, the secured creditor shall cause a public notice in two leading newspapers one in vernacular language having sufficient circulation in the locality by setting out the terms of sale, which shall include,—

- (a) the description of the immovable property to be sold, including the details of the encumbrances known to the secured creditor;
- (b) the secured debt for recovery of which the property is to be sold;
- (c) reserve price, below which the property may not be sold;
- (d) time and place of public action or the time after which sale by any other mode shall be completed;
- (e) depositing earnest money as may stipulated by the secured creditor;
- (f) any other thing which the authorised officer considers it material for a purchaser to know in order to judge the nature and value of the property.”

A reading of Rule 8(6) makes it very clear as to what are the relevant particulars to be furnished in the sale notice, as per which the description of the property to be sold among other particulars including the details of the encumbrance and any other thing which authorised officer considers it material for a purchaser to know in order to judge the nature and value of the property shall be known to the secured creditor by setting out the same in the public notice.²

Any asset sold under the SARFAESI Act is sold on “as is where is” and “as is what is” basis unless specified otherwise. Sale under SARFAESI is governed by terms and conditions of sale forming part of the sale process. The Bank /FI, while publishing its notice for auction sale of the property, *inter-alia* incorporates the following and brings to the notice of the public/bidders:

“Sealed tenders by way of submission of offer are invited from the general public for purchase of the immovable property possession of which have been taken by the bank under SARFAESI and the rule made there under on “as is where is” and “as is what is” condition under the said Act, for realisation of outstanding dues from the borrowers.”

“The Authorised Officer or the Bank shall not be responsible for any charge, lien, encumbrance, property or any other dues to the Government or any one else in respect of property auctioned”

After inviting the general public for purchase of the property under Public Auction, the following are the three stages under which payment is made by the successful bidder and upon completion of sale, the authorised officer shall issue sale certificate:

- (1) Earnest money deposit (at the time of bidding)
- (2) 25 per cent of the accepted sales price (including EMD) after successful bidding
- (3) 75 per cent of the balance amount within 15 days of the auction.

During the intervening period between the depositing of earnest money and till the balance sale consideration is paid, the auction bidder/purchaser after making part payment or full payment, may either demand to refund the amount from the authorised officer or request to cancel the sale if sale certificate is already issued on the ground that there exists encumbrance on the property or on the apprehension that title may not be proper and that the bank may not be competent to deliver possession of the auction property without encumbrance and free from any future litigation.

Under the above situation/circumstances, enforcement of securities and realising the liability through non-adjudicatory procedure are *per se* challenged and consequently the rights of the secured creditor under SARFAESI are not right in absolute.

Section 55(1) of Transfer of Property Act, 1882 stipulates as under:

"Rights and liabilities of buyer and seller.—In the absence of a contract to the contrary, the buyer and the seller of immovable property respectively are subject to the liabilities, and have the rights, mentioned in the rules next following, or such of them as are applicable to the property sold:

(1) The seller is bound—

- (a) to disclose to the buyer any material defect in the property or in the seller's title thereto of which the seller is, and the buyer is not, aware, and which the buyer could not with ordinary care discover;
- (b) to produce to the buyer on his request for examination all documents of title relating to the property which are in the seller's possession or power;
- (c)".³

A mere perusal of the above provision would show that duty is cast upon the authorised officer to disclose to the auction purchaser any material defect in the title, failing which it could be construed that purchaser was misled.

On the contrary, when the rule of *caveat emptor* (buyer beware) prevails, it is for the purchaser to either verify the title before purchasing the property or invite complication through litigation. However, now the rule of *caveat emptor* is replaced by *caveat venditor* (seller beware) and when the Bank/FI put the property on sale, they must show clear title to the said property.

Notwithstanding above, yet another aspect which we have to consider is the effect of Section 35 of the SARFAESI Act which reads as under:

"The provision of the fact shall have effect, notwithstanding anything inconsistent therewith contain in any of the law for the time being in force or any instrument having effect by virtue of any such law."

The effect of Section 35 would be that the disposal of the secured assets would be in terms of the provisions of the SARFAESI Act.⁴ Therefore, we may independently examine the legal provisions of the SARFAESI Act, upon which title is transferred by issuance of sale certificate without reference to the Transfer of Property Act since the right under SARFAESI would prevail over the other right.

The right is conferred of all the Bank/FI, as secured creditor to realise money by disposal of the property, over which the security is created. In case of public auction, the purchasers are put on notice that sale of properties in question was "as is where is and as is what is condition". Before commencement of the auction, the original documents pertaining to the property as well as copies of other parent documents and the relevant file are made available for all the participants for inspection. The

Bank/FI have to exercise due diligence on the security before the same is put on sale for the reason to rule out fraud, if any perpetrated by borrower and to rule out that the property is free from any encumbrance. Multiple mortgages are created by single borrower with different Bankers/FI and the secured creditor may or may not be aware of the any encumbrance on the property despite conducting due diligence. In view of the uncertainty in secured creditor being unaware of any encumbrance on the date of inspection of the property by the purchaser, whether the auction of the secured creditor is immune from challenge while recourse to action under Section 13(4).

In *V. Sambandan v. The Punjab National Bank* (MANU/TN/3041/2009) the Hon'ble Madras High Court observed that no one has compelled the Petitioner to go in for purchase of property and when the properties of the debtors were to be sold in "as is where is basis", it is for the Petitioner to have verified whether he was purchasing a property or a problem. In this case, the Petitioner after participating in auction defaulted in making further payment, on the ground that the Respondent Bank did not furnish the original title deed and copy of the other documents and it was therefore apprehended that the title may not be proper. Since the Petitioner had defaulted in making payment, the Respondent Bank forfeited the said amount in terms of Rule 9(5) of the Security Interest (Enforcement) Rules, which was challenged. The Hon'ble High Court, while dismissing the Petitioner's claim for refunding of forfeiture amount, relied upon the decision of Hon'ble Supreme Court in *United Bank of India v. Official Liquidator and Others* (MANU/SC/0592/1994). The Hon'ble Supreme Court held that the official liquidator shall not provide any guarantee and/or warranty in respect of the immovable properties and the purchaser shall not be entitled to claim any compensation or deduction in price on any account whatsoever and shall be deemed to have purchased property subject to all encumbrances, liens and claims including those under the existing legislation. The Hon'ble Supreme Court further observed that it is for the intending purchaser to satisfy himself in all respect as to the title, encumbrances, and so forth of the immovable property that he proposes to purchase and he cannot after having purchased the property on such terms then claim diminution in the price on the ground of defect in title or description of the property.

In *Jai Logistic v. The Authorized Officer, Syndicate Bank* (MANU/TN/1161/2010), the Hon'ble High Court of Madras directed the Respondent Bank to refund the earnest money to the Petitioner and suggested that it is for the Bank and financial institutions to indicate the encumbrance both by way of alienation in respect of the property or other statutory liabilities of the company or the individual as the case may be. In this case, the sale notice was published on 7th October, 2009, auction conducted on 9th November, 2009 and Petitioner paid earnest money deposit, however, refused to pay the balance sale consideration when Petitioner applied for encumbrance on 10th November, 2009 and came to know that a settlement deed had been executed by the owner of the land on 21st September, 2009. The earnest money deposit was forfeited by the Respondent Bank and it was contended that when the sale notice was issued, the Bank was not aware of the encumbrance and therefore the publication did not carry the encumbrance. The Hon'ble High Court while allowing the claim of the Petitioner, distinguished the judgment of the Hon'ble Supreme Court in *United Bank of India v. Official Liquidator & Others* (Supra) observed that provisions of the Security Interest (Enforcement) Rules as applicable in the present case are not applicable to the official liquidator. Rule 8(6)(f) mandates the secured creditors to set out in the terms of sale notice any other thing which the authorized officers considers it material for a purchaser to know in order to judge the

nature and value of the property and the Hon'ble High Court interpreted that the said rule would also include the encumbrance relating to the property and the intending purchaser to be put on notice as to the encumbrance, as otherwise he/she will be purchasing the property and simultaneously buying the litigation as well and an intending purchaser may not bid in the event he/she came to know of any encumbrance over the property.

In *Chemstar Chemicals & Intermediates (P) Ltd. v. The Commercial Tax Officer, Chennai and State Bank of Mysore*, the Hon'ble High Court of Madras held that order of attachment is one of the material factors which is likely to influence the mind of intending purchaser to proceed or not to proceed with his participation in the auction and even if the encumbrance certificate is made available for inspection before auction, the same would not amount to strict compliance with mandatory Rule 8(6) of the Security Interest (Enforcement) Rules, as per which the particulars of the encumbrance, if any, or any other factor which the Authorised Officer considers it material for an intending purchaser to be aware as referred to in Rule 8(6)(a) and (f) are to be disclosed in the public notice regarding sale. In this case, the Petitioner, after being declared as successful bidder, paid 25 per cent of the sale consideration on the date of auction and on applying for the encumbrance certificate later revealed the subsistence of order of attachment upon the property by Sales Tax Authorities for tax arrears and consequently filed the writ petition to refund of sale advance. The Hon'ble High Court, while allowing the claim of the Petitioner, has decided on two issues as under:

- (1) Whether Writ Petition is maintainable in view of statutory remedy available alternatively to approach DRT under Section 17 of the SARFAESI Act : The Hon'ble High Court observed that petitioner is only third party, who participated in the auction held in pursuance of the action taken under Section 13(4) of the SARFAESI Act and is not the person aggrieved against the action taken under Section 13 (4). What is challenged is the procedural violation in the manner of auction so held, not the auction itself. Hence the Hon'ble Court held that the plea of availability of alternate remedy raised is not maintainable.
- (2) If the documents containing encumbrance is made available along with the documents of title for inspection whether the same would amount to compliance under Rule 8 (6): The Hon'ble Court observed that Rule 8(6) makes it mandatory that the sale notice shall contain all the particulars including encumbrance if any and therefore even if the encumbrance are made available for inspection, it is rather necessary to disclose in the public notice regarding sale. The High Court referred to the decision of the Hon'ble Supreme Court in *Haryana Financial Corporation and Another v. Rajesh Gupta* wherein it was held that on the failure of the Corporation to disclose the fair description of the property to the buyer, the order of forfeiture of earnest money is arbitrary and unfair and directed the Corporation to refund the forfeited amount.

In *Haryana Financial Corporation & Another v. Rajesh Gupta*, the Hon'ble Supreme Court negated the submission that the secured assets are sold on "as is where is basis" and the purchaser cannot be permitted to wiggle out of a confirmed bid on the ground that there is material defect. The Hon'ble Supreme Court distinguished the powers of secured creditor and the official liquidator in selling the property and held that reliance placed on the judgment of the Supreme Court in *United Bank of India v. Official Liquidator & Others* is wholly misconceived. In the *United Bank of India's* case, it was observed that the official liquidator cannot and does not hold any guarantee or warranty in respect of the property sold. The Hon'ble Supreme Court in

this case held that the said judgment goes on to further hold that the case of the official liquidator selling the property of a company in liquidation under orders of the court is altogether different from the case of an individual selling immovable property belonging to himself and the corporation is exercising the right of an owner selling the property and not selling the property as an official liquidator.

A similar provision governing the Corporation as above is envisaged under the SARFAESI Act. Section 13(6) of the SARFAESI Act contemplates that any transfer of a secured asset would be considered as a transfer made by the owner of such secured asset. Rule 9(10) of the Security Interest (Enforcement) Rule states that the certificate of sale to be issued by the authorised officer shall specifically mention that whether purchaser has purchased the immovable secured asset free from any encumbrance known to the secured creditor or not. A plain reading of the SARFAESI Act/Rules would cast duty upon the Bank/FI to furnish those encumbrances which are known to them on the property which are sold by them. However, Rule 8(6)(f) mandates additional duty on the authorised officer to make known to the bidders before auction any other thing which the authorised officer considers it material for a purchaser to know in order to judge the nature and value of the property. The Hon'ble High Court of Madras in *Jai Logistic v. The Authorised Office, Syndicate Bank* interpreted that the said rule would also include the encumbrance relating to the property. In view of the pronouncement of various judgments described above, it is evident that the immunity claimed by the Bank/FI on the pretext "as is where is and as is what is basis" is dying a slow death and the Bank/FI being secured creditor, have to make due diligence/make thorough search of the property before proposing for sale. The borrowers are creating multiple registration of the same property subsequent to execution of mortgage with the Bank/FI and these frauds are rampant in the market. These frauds may not be known to the secured creditor in the normal course and if the property is sold "as is where is basis" without the knowledge of the subsequent encumbrances, there is apprehension that the auction proceedings could be stalled by the purchaser through the judicial intervention on the ground of non-furnishing of the material information relating to encumbrance. The ignorance of the secured creditor regarding the encumbrance on the property is no longer an acceptable argument in light of the decisions of court rejecting the plea of "as is where is". Hence, the Bank/FI have to tread very carefully before holding public auction and take all necessary steps to ascertain and furnish the information relating to encumbrance/attachment on the property to the intending purchaser.

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1. *M/s Sree Lakshmi Products v. State Bank of India* MANU/TN/7533/2007.
 2. *M/s Chemstar Chemicals & Intermediates (P) Ltd. v. The Commercial Tax Officer, Chennai and State Bank of Mysore* MANU/TN/2967/2010.
 3. *Haryana Financial Corporation & Another v. Rajesh Gupta* MANU/TN/1892/2009.
 4. *Krishna Lifestyle Technologies Ltd. v. Union of India* MANU/MH/0103/2008.