

## BAR ON CREATION OF SECURITY INTEREST ON AGRICULTURAL LAND IS NOT ABSOLUTE – SUPREME COURT ON SARFAESI

In the matter of *ITC Limited Vs Blue Coast Hotels Ltd., 2018(4) SCALE 628*, the Supreme Court dealt with the bar of security interest to be created on Agricultural Land, provided under Section 31(i) of the Securitization and Reconstruction of the Financial Assets and Enforcement of Security Interest, 2000 (**the Act**) and held that the bar is subject to the determination of purpose for which the agricultural land is held by the debtor. The Supreme Court, also discussed the nature of Section 13(3A) of the Act, which provides for a representation to be made by the debtor (before action under Section 13(4) is taken) and to be considered by the creditor and rejection of the offer to be supported by reasons. The Supreme Court held that compliance of this procedure is mandatory in nature.

**Facts:** Blue Coast Hotels Ltd. (**Blue Coast**) raised a loan, from the Industrial Financial Corporation of India (**IFCI**) by creation of a mortgage, under a loan agreement. The mortgaged property comprised of the whole of Blue Coast's Goa hotel property, including the agricultural land on which Blue Coast had proposed to develop villas. Blue Coast defaulted in repayment of the loan, and accordingly its account was declared a Non-Performing Asset. Consequentially, a notice under Section 13(2) of the Act was issued to Blue Coast. In reply Blue Coast made a representation/proposal to IFCI, seeking extension of time for repayment. However, IFCI went ahead and issued notice under Section 13(4) of the Act, thus taking symbolic possession of the mortgaged property.

Blue Coast in order to protect its interest, filed an application before the Debts Recovery Tribunal (**DRT**) against the action of IFCI under Section 13(4). The DRT held that the notice under Section 13(2) of the Act was bad in law, as the provisions of Section 13(3A) were not complied with by IFCI, and that the demand notice issued by IFCI included the agricultural land to which the provisions of the Act do not apply (Section 31(i) of the Act). This order of the DRT was challenged by IFCI before the Appellate Tribunal (**DRAT**) and was reversed and set aside.

Aggrieved by this order of the DRAT, Blue Coast approached the Bombay High Court by way of a writ

petition. However, during the pendency of the writ petition, Blue Coast made various representations/proposals to IFCI, seeking extension of time for repayment and deferring the auction sale of assets of Blue Coast. However, none of the representations/proposals made by Blue Coast materialized. After publication of the notice of auction three times, on the fourth occasion the auction was conducted, resulting in the sale of the Goa hotel property to ITC limited. Aggrieved by the auction sale another writ petition was filed by Blue Coast, before the Bombay High Court.

Upon hearing of the writ petitions the Bombay High Court confirmed the findings of the DRT setting aside the order of the DRAT, and declared the auction sale to ITC limited as void. Against this order of the Bombay High Court a special leave petition was preferred by ITC limited before the Supreme Court.

**Issues:** Based on the facts of the matter, the following issues came up before the Supreme Court:

- Whether it is imperative for the secured creditor to consider the representation/proposal made by the borrower and where such representation/proposal is not acceptable or tenable to the secured creditor, then to communicate the non-acceptance of the same to the borrower with reasons. In other words, whether the procedure provided under Section 13(3A) of the Act, is mandatory or not.

- Whether the inclusion of the agricultural land as security interest in the recovery notice invalidates the recovery notice, as the secured creditor cannot enforce any security interest in respect of agricultural land in view of the bar created under Section 31(i) of the Act.

**Mandatory Nature of Section 13(3A):** The Supreme Court noted the fact that sub-section 3A, was introduced by the legislature by transforming the observation made by the Supreme Court in ***Mardia Chemicals Vs Union of India, (2004) (4) SCC 311*** where a three judge bench of the Supreme court observed that it would be conducive to the principles of fairness, if the secured creditor would consider the representation/proposal made by the borrower in reply to the recovery notice issued by secured creditor and communicating to the borrower the reasons in case of rejecting the representation /proposal.

The Parliament transformed the observations of the Supreme Court into a provision of the Act with a plain intention to introduce a pause to be taken by the creditor to rethink and reconsider the representation/proposal proposed by the debtor. Therefore, it could not be the intention of the legislature to render futile a provision so introduced, by leaving it to the discretion of the secured creditor to ignore the representation/proposal and proceed to take measures.

The Supreme Court observed that Section 13(3A) clearly states that the secured creditor shall consider the representation/proposal made by the borrower and if such representation /proposal is not acceptable or tenable, the secured creditor shall communicate the reasons for non-acceptance to the borrower. Therefore, a provision which requires reasons to be furnished ought to be considered as mandatory and such a provision is an integral part of the duty to act fairly and reasonably and not fancifully. Hence, even if the legislature has not provided for any consequence for non-compliance with a duty to furnish reasons provided under Section 13(3A) of the Act, the

provision nonetheless is "mandatory". However, in view of the peculiar conduct of Blue Coast in time and again making representations to IFCI and then defaulting on them, the Supreme Court denied any relief to Blue Coast in this regard.

**Creation of Security interest on Agricultural Land:**

It was contented before the Supreme Court that the inclusion of agricultural land as security interest in the recovery notice could not be valid in view of section 31(i) of the Act which bars creation of such interest. The Supreme Court observed that the purpose of enacting Section 31(i) of the Act is to protect agricultural lands held for agricultural purposes by agriculturists from the extraordinary provisions of the Act, which provides for enforcement of security interest without intervention of the Court. In other words, the creditor cannot enforce any security interest created in his favour without intervention of the Court, if such security interest is in respect of agricultural land. The exemption thus protects agriculturists from losing their source of livelihood and income i.e. the agricultural land, under the drastic provisions of the Act.

However, reverting to the facts and circumstances of the matter the Supreme Court observed that the mortgage created by Blue Coase was intended to cover the entire property of the Goa hotel. *Prima facie*, apart from the fact that the parties themselves understood that the lands in question are not agricultural, it was observed that having regard to the use to which such lands were put and the purpose of such use, the land indeed was not agricultural and will not be saved by the bar created under Section 31(i) of the Act.

In coming to this conclusion, the Supreme Court placed reliance on the judgment of ***Commissioner of Wealth Tax, Andhra Pradesh v. Officer-in-Charge (Court of Wards) Paigah (1976) 3 SCC 864***, where the Supreme Court interpreted definition of the term 'Agricultural Land' with respect to the provisions of the Wealth Tax Act, 1957. It was observed by the Supreme Court that, the determination of the character of land, the purpose for which it is meant or

set apart and can be used, is a matter which ought to be determined on the facts of each particular case, the Supreme Court went on to hold that:

***"What is really required to be shown is the connection with an agricultural purpose and user and not the mere possibility of user of land, by some possible future owner or possessor, for an agricultural purpose. It is not the mere potentiality, which will only affect its valuation as part of "assets", but its actual condition and intended user which has to be seen for purposes of exemption from wealth-tax. One of the objects of the exemption seemed to be to encourage cultivation or actual utilisation of land for agricultural purposes. If there is neither anything in its condition, nor anything in evidence to indicate the intention of its owners or possessors, so as to connect it with an agricultural purpose, the land could not be "agricultural land" for the purposes of earning an exemption under the Act. Entries in revenue records are, however, good prima facie evidence."*** (Emphasis Supplied)

Applying this test, the Supreme Court observed that having regard to the character of the land and the purpose for which it is set apart, the land in question is not agricultural land, and further observed that the High Court mis-directed itself in holding the land as an agricultural land merely because it stood as such in the revenue entries, even though the application made for such conversion was pending.

**Analysis and Conclusion:** Notably, the Bombay High Court (High Court) while arriving at the conclusion that the agricultural land is not susceptible to the provision of the Act, observed that there is no bar or prohibition for the financial institutions and banks to invoke other laws and related provisions for enforcement of security interest, and that Section 37 of the Act, contemplates the application of other laws

for recovery of debts. Further, the application of Blue Coast for conversion of land to non-agricultural was pending and therefore, unless specifically ordered any use of land for non-agricultural purpose, including the constructions made thereupon are treated as impermissible, illegal and unauthorized. The High Court further observed that permitting and/or allowing such agricultural land to be used for garden and/or special related purpose, by not producing any agricultural products for some time and/or because of non-use of agricultural land for long, that itself cannot be the reason to treat the land as non-agricultural land. The High Court further fortified its conclusion by placing reliance on the judgment of the Supreme Court in ***State of Karnataka Vs Shankara Textile (1995) 1 SCC 295***, where it was held that no agricultural land can be used or treated as non-agricultural land without obtaining prior permission of the concerned authorities.

Departing from the aforesaid position of law set out by the Supreme Court, and setting aside the findings of the High Court, the Supreme Court in the present case, chose to lay down the purpose and user test for the purpose of determining the applicability of the bar under Section 31(i) of the Act. Since the test is a subjective test, in our view, in time to come the test would be susceptible to much mischief by the borrowers. On the other hand, the Supreme Court in the *State of Karnataka (supra)* (relied upon by the Bombay High Court, in the present case) has taken a strict and objective approach, which is not susceptible to any mischief, and it would be for the lenders to be cautious whilst accepting agricultural land as security. In view of the test laid down by the Supreme Court, in the present case, we foresee precious judicial time of the tribunals/courts being wasted to determine the purpose.

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