CIVIL

SARFAESI Act and Inter-Bank Disputes Over Secured Assets: Supreme Court's Clear Stance on Arbitration

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In a recent judgment, the Supreme Court of India has reaffirmed the applicability of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) in disputes between banks over secured assets. The case, Bank of India versus M/S Sri Nangli Rice Mills Pvt. Ltd. & Ors., highlights the complexities and legal nuances involved in resolving financial disputes under the SARFAESI Act.

Table of contents

Background of the Case

The case involves a complex financial dispute between prominent banks, the Bank of India and Punjab National Bank, over secured assets. M/S Sri Nangli Rice Mills Pvt. Ltd., the borrower, had availed credit facilities from both banks. Initially, in 2003, the borrower hypothecated stocks of paddy and rice to the Bank of India. Subsequently, in 2013, the same stocks were pledged to Punjab National Bank. The borrower defaulted on the loan repayment to the Bank of India in 2015, prompting the bank to initiate recovery proceedings.

Proceedings and Decisions

The legal journey of this case has been complex, involving multiple stages and decisions. Initially, the Bank of India sought assistance from the District Magistrate to take physical possession of the secured assets. The District Magistrate allowed the bank to take possession but excluded the stocks pledged with Punjab National Bank. This decision was challenged by the Bank of India in the High Court of Punjab and Haryana, which directed the bank to approach the Debt Recovery Tribunal (DRT) instead.

In the first round of proceedings before the DRT, the Bank of India filed a securitization application. The DRT ordered a joint sale of the secured assets by both banks and directed the sale proceeds to be deposited with the State Bank of India until the final adjudication of rights. This decision was appealed by the respondent bank to the Debt Recovery Appellate Tribunal (DRAT), which remanded the matter to the DRT, holding that the DRT failed to consider the preliminary objection regarding the maintainability of the application under Section 17 of the SARFAESI Act.

On remand, the DRT held that it had no jurisdiction to adjudicate the dispute between the two banks and directed them to resolve the dispute through arbitration under Section 11 of the SARFAESI Act. The Bank of India approached the High Court through a writ petition, but the High Court upheld the DRT’s decision, affirming that the dispute should be resolved through arbitration under Section 11 of the SARFAESI Act.

Rival Contentions

The case presents a clash of legal interpretations. The Bank of India argued that Section 11 of the SARFAESI Act is inapplicable as there is no legitimate dispute between the banks. They contended that the charge created by Punjab National Bank through pledge is null and void due to the terms of the Credit Facility Agreement. The bank also asserted that the High Court erred in relying on the decision in Oriental Bank of Commerce, which held that disputes between banks must be resolved through arbitration under Section 11.

On the other hand, Punjab National Bank contended that Section 11 of the SARFAESI Act applies to disputes between banks and financial institutions. They argued that the dispute falls within the scope of Section 11 as it relates to non-payment of dues and competing claims over the same security. The bank submitted that the High Court correctly held that the DRT has no jurisdiction to adjudicate such inter-se disputes.

Legal Provisions and Judgments Relied Upon

The Supreme Court's judgment relied on several key legal provisions and precedents. Section 11 of the SARFAESI Act mandates arbitration for disputes relating to securitization, reconstruction, or non-payment of any amount due between banks, financial institutions, asset reconstruction companies, or qualified buyers. Section 17 of the SARFAESI Act allows borrowers to challenge actions taken under Section 13 by filing an application before the DRT.

The Court also referred to the judgment in Oriental Bank of Commerce v. Canara Bank, which held that disputes between banks must be resolved through arbitration under Section 11. Additionally, the Court considered Federal Bank Ltd. v. LIC Housing Finance Ltd., which held that Section 11 requires a written arbitration agreement between the parties.

Analysis of the Court

The Supreme Court conducted a thorough analysis of the legislative history and scheme of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). The Court emphasized the need for speedy recovery of non-performing assets (NPAs) and the role of arbitration in resolving inter-se disputes between financial entities. The Court held that Section 11 of the SARFAESI Act is mandatory and creates a legal fiction of an arbitration agreement between the specified parties. The expression "non-payment of any amount due, including interest" in Section 11 is broad and includes disputes arising from third-party defaults, such as borrower defaults.

Further, the Court clarified that the Debt Recovery Tribunal (DRT) would lose its jurisdiction to adjudicate the dispute, and the dispute would be settled through arbitration under Section 11 upon fulfilment of twin conditions. First, the dispute must be between any bank or financial institution, asset reconstruction company, or qualified buyer. Secondly, the dispute must relate to securitization, reconstruction, or non-payment of any amount due, including interest.

The Court concluded that the DRT has no jurisdiction to adjudicate disputes between banks and financial institutions falling under Section 11, and such disputes must be resolved through statutory arbitration. This decision underscores the importance of arbitration in ensuring timely and efficient resolution of inter-bank disputes, thereby reinforcing the legal framework for asset recovery and enforcement.

Conclusion

The Supreme Court's decision in the case of Bank of India versus M/S Sri Nangli Rice Mills Pvt. Ltd. & Ors. emphasises the importance of arbitration in resolving complex disputes between banks, financial institutions, asset reconstruction companies, or qualified buyers under the SARFAESI Act. By upholding the High Court's decision, the Court has provided clarity on the applicability of Section 11 and reaffirmed the role of arbitration in ensuring timely and efficient resolution of inter-bank disputes. This judgment is expected to have significant implications for the financial sector, guiding future disputes and reinforcing the legal framework for asset recovery and enforcement.

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