HONOURABLE SRI JUSTICE SANJAY KUMAR
AND
HONOURABLE SRI JUSTICE P.KESHAVA RAO

WRIT PETITION NO.8245 OF 2019

O R D E R
(Per Sanjay Kumar, J)

1. The petitioners were the highest bidders in the auction sale of a secured asset held by the Indian Overseas Bank on 27.08.2018. This sale was conducted under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (*for brevity*, 'the SARFAESI Act'). While so, they filed S.A.No.399 of 2018 before the Debts Recovery Tribunal-II, Hyderabad (*for brevity*, 'the Tribunal'), to declare the said sale illegal and to award them damages and compensation of Rs.10,00,000/-. By order dated 09.04.2019, the Tribunal dismissed the S.A. Aggrieved thereby, they filed the present writ petition.

2. The admitted facts, to the extent relevant, are as follows: The Indian Overseas Bank (for brevity, 'the bank') conducted the e-auction sale of a secured asset, viz., Flat No.302, situated on the third floor of 'Sai Arcade' at Plot No.48 in Survey Nos.329/1, 330/1 and 331 of Chandanagar Village, Serilingampally Circle, Ranga Reddy District, under the provisions of the SARFAESI Act, on 27.08.2018. This secured asset belonged to one C.Naresh, who had created a security interest therein in favour of the bank. The petitioners became the highest bidders in this auction sale with a bid of Rs.25.60 lakhs. They immediately deposited 25% of the sale consideration. Confirmation of the sale was effected by the bank on 29.08.2018 calling upon the petitioners to deposit the balance sale consideration of Rs.19.20 lakhs within fifteen days. The petitioners claim to have approached another financial institution at that stage to avail financial assistance to pay the balance sale consideration and in that

process, they obtained an encumbrance certificate in relation to the subject flat on 07.09.2018 from the Sub-Registrar's office at Serilingampally. They then came to know that C.Naresh, the owner, had executed registered Agreement of Sale-cum-General Power of Attorney dated 31.10.2014, bearing Document No.6403/2014, in favour of one Vallabhaneni Hymanjali. In view of this encumbrance, the petitioners assert that they could not secure a loan from the other financial institution. They addressed letter dated 10.09.2018 to the bank asking it to take necessary action for getting the encumbrance nullified.

3. However, by letter dated 19.09.2018, the bank disclaimed responsibility stating that the subsequent encumbrance created on 31.10.2014 was not binding on it. It further stated that it could pass valid title/legal right to the property and that it was not possible for it to cancel the subsequent encumbrance since it was not a party to that transaction. The bank accordingly called upon the petitioners to pay the balance sale consideration so that it could issue the sale certificate and register the same. The bank advised the petitioners that as the purchasers-owners of the property, they could take whatever measures they wished, to protect their interest in the property. The petitioners again addressed letter dated 25.09.2018 to the bank requesting it to clear the cloud on title. However, there was no response to their request but the bank pressurised them to pay the balance sale consideration. Under threat of forfeiture of the amount already deposited, the petitioners deposited the balance sale consideration and the bank issued them a sale certificate on 03.10.2018. Physical possession of the flat was however not delivered to them.

4. It was in these circumstances that the petitioners filed S.A.No.399 of 2018 before the Tribunal. Their prayer therein was to declare the

e-auction sale notice dated 27.08.2018 as illegal and consequently, to direct the bank to refund the entire bid amount with interest. They also asked for damages and compensation to the tune of Rs.10.00 lakhs from the bank for *malafide* conduct of the e-auction sale, without notifying the encumbrance, and for the loss sustained by the petitioners, apart from mental agony and stress that they had to undergo in the process. By the order under challenge, the Tribunal held against them on all counts.

5. Perusal of the order under challenge demonstrates that the Tribunal was influenced by the fact that the bank had sold the property on an 'as is where is' and 'as is what is' basis. It took note of the fact that Clause 11 of the e-auction sale notice dated 07.08.2018 specified that the bank had disclosed only known encumbrances and statutory liabilities and it was for the purchaser to make his own independent enquires at his own cost before participating in the auction. The Tribunal further observed that the registered Agreement of Sale-cum-General Power of Attorney dated 31.10.2014 was long after the mortgage was created in favour of the bank on 07.12.2011 and therefore, the same could not be cited as a ground to nullify the auction sale. Reliance placed by the petitioners upon the decision in MANDAVA KRISHNA CHAITANYA V/s. UCO BANK, ASSET MANAGEMENT BRANCH[1], was rejected by the Tribunal on the ground that the facts in that case were entirely different and distinctive. The Tribunal concluded that it was for the petitioners to make their own independent enquiries before participating in the auction and as the sale certificate had already been issued and the bank was ready to put them in possession, the auction sale held on 27.08.2018 could not be categorised as illegal. It was on this basis that the Tribunal dismissed the S.A.

[1] 2018 (3) ALD 266 = 2018 (2) ALT 640

6. Heard Sri G.K.Deshpande, learned counsel for the petitioners, and Sri G.Vasantharayudu, learned counsel appearing for Sri Bachina Hanumantha Rao, learned counsel for the bank.

7. Having given our earnest consideration to the case, we are of the opinion that the issue ultimately boils down to whether the bank had any responsibility to undertake due diligence and enquire into encumbrances, if any, that attached to the secured asset, before putting it to sale. This issue is no longer *res integra* in the light of our decision in MANDAVA KRISHNA CHAITANYA[1]. Therein, we, as a Division Bench of the High Court for the States of Telangana and Andhra Pradesh, observed that even if a bank makes it one of the conditions of the auction sale notice that the property in question is sold on an 'as is where is' and 'as is what is' basis, the question is whether the same would be sufficient for it to claim protection and immunity. Reference was made to the statutory scheme obtaining under the SARFAESI Act and the Security Interest (Enforcement) Rules, 2002 (*for brevity,* 'the Rules of 2002'), framed thereunder, and more particularly Rule 8(6)(a) and (b) thereof. These clauses state to the effect that the secured creditor needs to mention in the public notice that would be published in the newspapers not only the description of the immovable property proposed to be sold but also the details of the encumbrances known to the secured creditor and any other thing which the authorised officer considers material for a purchaser to know in order to judge the nature and value of the property. Rule 9(6) of the Rules of 2002 also elaborates upon the responsibility of the secured creditor to issue a certificate of sale of the immovable property in favour of the purchaser in the form given in Appendix V, which contains a recital that the sale of the secured asset was made free from all encumbrances

known to the secured creditor. The other sub-rules in Rule 9 also shed light on this aspect. It was on the strength of this statutory scheme that we had held in MANDAVA KRISHNA CHAITANYA[1] that a bank may sell a secured asset which is not free from encumbrances but an endeavour must necessarily be made by it to know as to what encumbrances attach to the secured asset. We further observed that a secured creditor could not blindly accept any property as security and go on to sell the same without even enquiring as to what encumbrances attached to it. We noted that a bank offers loan facilities on the strength of such secured assets and, in most cases, such loan facilities are sourced from public funds and held that a high level of responsibility attaches to a bank to ensure that the secured assets, on the strength of which they offer tax-payers' or customers' monies to borrowers, are worthy of being mortgaged as security for such loans. We accordingly held that it was not open to a bank to baldly state that it had obtained an asset as security for the loan sanctioned and once it proposed to sell it on an 'as is where is' and 'as is what is' basis, it is freed from all responsibility. Having referred to case law on the subject, we observed as under:

> 'In terms of the statutory scheme of the SARFAESI Act and the Rules of 2002 and given the weighty preponderance of judicial wisdom, as set out *supra*, a secured creditor who is empowered under the SARFAESI Act to enforce any secured interest created in its favour, without the intervention of a Court or a Tribunal, but in accordance with the procedure prescribed therefor, cannot take the responsibility resting upon it lightly. Such a secured creditor not only owes a duty to protect the interest of the borrower by raising the best possible price while selling his mortgaged properties, but also owes a duty to the auction purchaser to verify the encumbrances that attach to the mortgaged property proposed to be sold, so as to inform all intending bidders of the same. Clauses

(a) and (f) in the *proviso* to Rule 8(6) of the Rules of 2002 bear out this responsibility explicitly, as the secured creditor is mandated thereunder to include the details of the encumbrances known to it and also any other thing which may be considered material for a purchaser to know in order to judge the nature and value of the property. These clauses therefore visit a duty upon the secured creditor to undertake due diligence at least at the stage of putting the secured asset to sale, if not at the time of taking the said property as security while granting loans, so that the bidders in the auction can rest assured that the bank has taken necessary measures in this regard and proceed to participate in the auction sale. Ignorance of the secured creditor as to the encumbrances on the property sold by it is no longer an acceptable argument in the light of the decisions of various Courts rejecting the plea that a sale on 'as is where is' basis constitutes a shield of protection.'

8. Unfortunately, the Tribunal baldly distinguished the aforestated judgment on the ground that the facts of the case were distinctive and different without even understanding its *ratio decidendi*. The contrary finding recorded by the Tribunal that it was for the petitioners themselves to make their own independent enquiries before participating in the auction clearly negates the legal principle laid down in MANDAVA KRISHNA CHAITANYA[1]. It is distressing to note that the Tribunal cast aside judicial discipline while considering a decision that was binding upon it and failed to draw necessary inferences by understanding the import of the said decision.

9. In the counter filed before us, the bank would again contend that it sold the flat on an 'as is where is' basis and that it was for the petitioners to take necessary precautions before participating in the auction.

10. However, as already pointed out *supra*, this stand is not available to the bank given its own responsibility in the statutory scheme, set out *supra*. There is no indication of the bank having even obtained an

encumbrance certificate from the registration authorities before putting the subject flat to sale. No doubt, the impact of the subsequent registered agreement of sale-cum-general power of attorney would have to be examined in the light of the fact that mortgage was created long prior thereto, but the inescapable fact remains that the petitioners would not only buy the flat but also the litigation that would have to arise from this later development. When the rules require the bank to disclose material facts for a purchaser to judge the 'nature' and 'value' of the property being sold, the negligence on the part of the bank in disclosing the factum of execution of a registered document after creation of the mortgage, which opened up the possibility of litigation, necessarily had to be disclosed by it. This failure on the part of the bank is fatal and it cannot seek to justify the nonchalant and careless sale undertaken by it on 27.08.2018. The order of the Tribunal holding to the contrary is therefore unsustainable on facts and in law.

11. On the above analysis, the order dated 09.04.2019 passed by the Tribunal in S.A.No.399 of 2018 is set aside and the said S.A is allowed. In consequence, the auction held on 27.08.2018 is set aside. The bank shall refund the sale consideration of Rs.25.60 lakhs to the petitioners along with interest thereon @18% per annum, from the date of deposit till the date of realisation, within two weeks from the date of receipt of a copy of this order. This interest rate is adopted as the bank was at fault for this entire imbroglio and the petitioners were made to part with their valuable monies with no resulting benefit therefor, while the bank enjoyed their monies all through. Significantly, this was the rate of interest applied by

the Supreme Court in like circumstances in MATHEW VARGHESE V/s. AMRITHA KUMAR[2].

12. The writ petition is accordingly allowed Pending miscellaneous petitions, if any, shall stand closed in the light of this final order. The bank shall also pay costs of Rs.10,000/- to the petitioners.

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JUSTICE SANJAY KUMAR

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JUSTICE P.KESHAVA RAO

14th AUGUST, 2019

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[2] (2014) 5 SCC 610