

RECOVERY OF ASSETS, BY ASSET FINANCE COMPANIES (AFCs) UPON DEFAULT IN REPAYMENT OF AGRICULTURAL EQUIPMENT LOANS

A sense of uncertainty and confusion prevails amongst institutions that are engaged in the financing of agricultural equipment. This uncertainty is rooted in sentiment rather than law, to wit that the State and the Judiciary would frown upon recovery, by the financing institution, from defaulting borrowers, of agricultural equipment for the acquisition of which the loan had been extended. Apprehensions, on this account, have tended to sharpen in recent times after farmers were reportedly driven to suicide upon being harangued and threatened by recovery agents whereas, in contrast, Vijay Mallya allegedly cocked a snook at banks that have lent him in excess of Rs. 7000 crore. While there is no gainsaying the fact that ham-handed, rough shod, coercive and insensitive recovery methods have often attracted flak from courts besides civil society and media criticism, it is equally important to understand that a financing institution is fully competent, in law, to recover equipment financed, on say a hire purchase basis, to an agricultural borrower who fails to pay the agreed instalments at the stipulated intervals.

Although there is no Central Government order dealing with AFC NBFC (Asset Finance Company Non-Banking Finance Company) business. However, repossession, by an AFC, is governed by (a) Supreme Court judgments and (b) RBI Circular of March 26, 2012 prescribing “**Guidelines on Fair Practices Code for NBFCs**”.

(A) Supreme Court Judgments

In *Charanjit Singh Chadha & Ors vs Sudhir Mehra*; (2001) 7 SCC 417; where it was alleged that financiers forcibly took away the vehicle from a mechanic who had obtained the vehicle under a hire purchase agreement, upon failure of the latter to pay instalments due; the Hon’ble Court held that when the agreement (of hire purchase) specifically says that the owner has got a right to repossess the vehicle, there cannot be any basis for alleging that the appellants (financiers) have committed criminal breach of trust or cheating. The hire purchase agreement, in law, is an executory contract of sale and confers no right in rem on the hirer until the conditions for transfer of property

to him have been fulfilled. Therefore, repossession of goods, as per the terms of the agreement, may not amount to any criminal offence.

In *The Managing Director, Orix Auto Finance (India) Ltd. Vs Shri Jagminder Singh and Another*; 2006 (1) SC 708; the Hon'ble Supreme Court deprecated the practice, in some High Courts, of adversely viewing the repossession of vehicles by financiers. Held, that if repossession is clearly permitted in terms of the hire purchase agreement and unless a party shows that the contract itself is unconscionable or opposed to public policy, the scope of judicial interference in such contractual matters is virtually non-existent.

(B) RBI GUIDELINES

RBI, vide **Circular No. DNBS.CC.PD.No.266 03.10.01/2011-12 dated 26 March 2012** prescribed "**Guidelines on Fair Practices Code for NBFCs**". Therein, RBI laid down certain norms to be followed in relation to repossession of vehicles by NBFCs.

To summarise:

1. There must be a built-in repossession clause in the contract/ loan agreement with the borrower which must be legally enforceable.
2. The contract/ loan agreement should also contain provisions regarding **(a)** notice period before retaking possession; **(b)** circumstances under which the notice period can be waived; **(c)** the procedure for taking possession of the security; **(d)** a provision regarding final chance to be given to the borrower for repayment of loan before the sale/ auction of the property; **(e)** the procedure for giving repossession to the borrower and **(f)** the procedure for the sale/ auction of the property.
3. A copy of the aforesaid terms and conditions must be provided to the borrower as part of the loan agreement or as enclosures to the loan agreement, as the case may be at the time of sanction/ disbursement of the loan.
4. Recovery should normally be made only at a centrally designated place. Field staff should be allowed to make recovery at the place of residence

or work of the borrower only if the borrower fails to appear at the centrally designated place on two or more successive occasions.

5. A code of conduct should be followed by the field staff along with systems for their recruitment, training and supervision. Training to field staff should include programs to inculcate proper behavior towards borrowers without adopting any abusive or coercive debt collection/recovery practices.

Generally only employees and not outsourced recovery agents be used for recovery in sensitive areas. NBFCs are not to resort to undue harassment viz persistently bothering the borrower at odd hours, use of muscle power for recovery of loans etc.

A compliance mechanism (with the RBI Guidelines) should be in place within the NBFC. All communications to the borrower should be in the vernacular language.

The Recovery Environment

States do not, generally, have specific laws bearing upon asset repossession though some, like Tamil Nadu, do have laws to protect depositors in Ponzi schemes run by NBFCs.

In Andhra Pradesh, the High Court, on 12 February 2013, upheld the **Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Act**, which prohibits any Micro Finance Institution (MFI) from employing any recovery agents other than its own employees and stipulated the MFI shall collect repayment of the instalment due only in a public place.

Interest and KYC

Generally, there is no specific lock-in period mandated (after disbursement of the agricultural equipment loan) before interest can be levied thereon. However, the prevailing juridical, administrative, societal and financial ambience would necessitate that **(a)** interest should subsume all charges; **(b)** interest be not so structured so as to exceed the principal; **(c)** thorough credit appraisal and borrower education be done before disbursement. These, and other, guidelines can be seen from the RBI Circular cited above.

Likewise, there are no overarching and specific limits/restrictions on lending by an AFC NBFC but these would arise from commercial lending norms pertaining to credit appraisal, creditworthiness, interest charged, terms of lending etc., so as to obviate charges of usury.

Finance by AFC NBFC and entitlement to subsidy

A question often asked is that when leasing of the agricultural/farm equipment/ machineries is done by an AFC NBFC, can the buyer (individual, corporate, group of farmers etc., taking the equipment on higher purchase from the lending institution) receive the subsidy from the respective State Government?

The answer would depend on the particular case and the kind of documentation carried out. Nonetheless, if the lease carries a purchase option, for the lessee, at the end of the lease period, it should be possible to put up a strong argument for subsidy but this would depend on the circumstances in each case.

Financing of Tractors and Rice Transplanters

Tractor financing would provide the NBFC with the additional security of the vehicle being designated as hypothecated to the financier in the records of the RTO (Regional Transport Office). In fact, NDFCs have been taking greater interest in tractor finance ever since the slump in commercial vehicle sales. Transplanters would come in a similar category.

As the regulation and right of the repossession would apply to Tractor/Rice Transplanters, it would be possible to mention the “**Surrender clause**” on the agreement between the AFC and customer. Thereby, it would entitle the financing institution to take the machine from the customer after the customer surrenders the repayment. However, this would be practicable only if it is purely a lease (and not hire purchase) agreement. In such cases, the law provides for the insertion of a “Surrender Clause” in a contract of lease and has been recognised as such in Section 115 of the Transfer of Property Act. This is now common practice among luxury car vendors who enter into a three year lease with customers. Upon expiry of that time, the vehicle either reverts to the

dealer under the Surrender Clause or the customer exercises the option to make a down payment and have the ownership of the vehicle transferred to him.