

Constitutionality of the Reserve Bank of India Circular Dated Feb 12, 2018- An Analysis of the Supreme Court's discernment

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Abstract

The case note will analyse the Supreme Court's verdict on the constitutionality of the Reserve Bank of India Circular dated Feb 12, 2018. It will provide the gist of February 12, 2018 Circular by focussing on the facts, issues and judgement of the case. It will also summarize Sections 35AA and 35AB of the Banking Regulation Act.

Key Words: Default, Insolvency and Bankruptcy Code, Section 35AA and 35AB of Banking Regulation Act, Reserve Bank of India's Feb 12 Circular.

INTRODUCTION

The Reserve Bank of India vindicated its February 12 order enunciating that it would ameliorate the credit culture and credence between counterparties in a transaction as it directed the lenders to refer an account with over INR 2,000 crore loans to the bankruptcy court if it is not resolved within 180 days of default.¹ According to the Reserve Bank of India, the revamped stratagem not only aimed to provide pliability to borrowers and lenders, but it also ensures the implementation of the resolution plan within a stipulated timeframe.

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¹Anonymous. Constitutional validity of the impugned circular issued by the RBI- Dharani Sugars and Chemicals Ltd. Vs. UOI &Ors.- SC. <<https://ibclaw.in/constitutional-validity-of-the-impugned-circular-issued-by-the-rbi-dharani-sugars-and-chemicals-ltd-vs-uo-ors-sc/>> accessed 09/07/2019.

ENCAPSULATION OF THE FEBRUARY 12, 2018 CIRCULAR

The revised scheme also endeavours to ingrain the indispensable discipline mechanism for a single day default in the context of bank loans, corresponding to the market discipline to which the borrowers elevating money through debt markets are subject.²

The draconian RBI circular that was issued on February 12, 2018 notifies that even a single day's deferment in servicing loans would be contemplated as a 'default'. And once in non-remittance for loans above Rs 2,000 crore, the banking institutions will have to arrive at a resolution within duration of 180 days.³ If a resolution strategy is not attained within the stipulated period, the lenders will have to file an application within a period of 15 days under the Insolvency and Bankruptcy Code. It remoulded the banking landscape and transmuted the way lenders and borrowers behaved.⁴ In cursory, the "Resolution of Stressed Assets- Revised Framework" (also known as the February 12 Circular of the Central Bank) postulates that if the company does not make a timely payment then the business enterprise would be up for sale.⁵

It foisted resilient loan stipulations on the lenders & borrowers and has thrashed hard on the power and infrastructure companies. The circular interdicted loan restructuring and exhorted banks to proclaim a company a non-performing asset even if there was a day's deferral in the repayment of loan. The bankers posited the circular succoured them to rein in erring promoters and chief executive officers. It has made sure that the bungling promoters now approach to the table to parley.⁶

THE SUPREME COURT QUASHES THE RBI'S FEBRUARY 12, 2018 CIRCULAR ON DEBT RESOLUTION

The Supreme Court's judgment on the RBI circular dated 12th February 2018 is a disquisition about the subject of interpretation of statutes.⁷ The judgment sound on its rationale, struck down the RBI's circular through which it had entreated the lenders to initiate a board-approved strategy for the resolution of stressed assets. The circular that was set aside accorded the defaulting companies with indebtedness over Rs 2,000 crores a timeframe of 180 days to concur on a resolution scheme with lenders or be taken to the National Company Law Tribunal to recoup the debt. The Court held that the circular was ultra vires of Section 35AA of the Banking Regulation Act and the Reserve Bank of India had no authority to issue such an order under the contemporary statutory contrivance.⁸

²Sunny Verma (2019, April 3). Why SC order on RBI's controversial 'February 12 circular' matters. *The Indian Express*, pp.1.

³Anonymous. (2019, April 2). Supreme Court sets aside RBI's February 12 circular on bad loans, calls it 'unconstitutional'. *Business Today*, pp.1,2.

⁴Abhijit Lele. (2019, April 2). SC verdict on RBI's Feb 12 circular to prolong resolution of stressed debt. *Business Standard*, pp.1.

⁵Venkatesh Ganesh. (2019, April 2). Supreme Court strikes down RBI's Feb 2018 order on stressed assets. *Business Line*, pp.1.

⁶Rhea Arora. (2019, April 4). Supreme Court rejects February '18 RBI circular: Was it the right move? *Qrius*, pp.1.

⁷Anonymous. SC's RBI Circular judgment: A Treatise On Interpretation Of Statutes. <https://www.livelaw.in/columns/scs-rbi-circular-judgment-an-overview-144144> accessed 09/07/2019.

⁸Anonymous. (2019, April 2). SC declares February 2018 RBI Circular ultra vires. *SCC Online*, pp.1

Dharani Sugars and Chemicals Ltd. v. Union of India & Ors. (2 April 2019)⁹

The writ petitions confronting the Circular were brought before various High Courts in 2018. They were later coalesced jointly and entrusted to the Apex Court. The only unassailable pronouncement on this matter was the one given by the (Allahabad) High Court, which rebuffed to stay the operation of the RBI Circular. The confrontations to the Circular have been precipitated by pressure groups of the Power Sector contending their idiosyncratic state which vindicated exceptional treatment by the Reserve Bank of India.¹⁰ The petitioners challenged the constitutional validity of Section 35AA and 35AB of Banking Regulation Act and the powers of Reserve Bank of India's Feb 12 Circular in relation to the Banking Regulation Act and the Reserve Bank of India Act.¹¹ The main contretemps was that the reason for their incapacity to reimburse the debts was because of circumstances beyond their control. The two prime issues before the Apex Court were:

- 1) A propos the constitutional validity of Sections 35 AA and 35AB of the Banking Regulation Act, 1949 which were incorporated by way of amendment in May 2017.
- 2) The Reserve Bank of India Circular was questioned as being ultra vires of Section 35AA of the Banking Regulation Act.¹²

Nonetheless, the cardinal challenge was made with regards to the authority given to the Reserve Bank of India to push the comrporte entities into the Corporate Insolvency Resolution Process.¹³

THE APEX COURT'S VERDICT

The contentious feature of the RBI circular was that it directed the banking institutions to file insolvency petitions in the event they failed to achieve the debt restructuring plan within a timeframe of 180 days. First the companies from the power sectors and then the companies from other sectors such as textile and sugar condemned that the Reserve Bank of India has surpassed its limit in pushing up banks to file for insolvency. The Supreme Court concurred with that argument and henceforth, quashed the February 12 circular.¹⁴ The Apex Court decided the matter as follows:

- CONSTITUTIONALITY OF SECTIONS 35AA AND 35AB OF THE BANKING REGULATION ACT

The Supreme Court ratified the constitutional validity of Sections 35AA and 35AB of the Banking Regulation Act as being fair and equitable along with being directed by explicit statutory considerations. Also, the court followed it srulingin Swiss Ribbons

⁹Supreme Court. Dharani Sugars and Chemicals Ltd vs Union of India. <<https://indiankanoon.org/doc/167944367/>> accessed 09/07/2019.

¹⁰Aashish Aryan (2019, March 6). RBI circular has one-size-fits-all approach, power firms tell SC. *Business Standard*, pp. 1.

¹¹Anonymous. (2019, April 2). SC scraps 12 February RBI circular: Legal fraternity divided over apex court order on NPA diktat. *Press Trust of India*, pp.1

¹²Alipak Banerjee & Vyapak Desai. Supreme Court strikes down the RBI circular on the resolution of stressed assets: Analysis and Implications. <https://barandbench.com/supreme-court-strikes-down-the-rbi-circular-analysis-and-implications/> accessed 10/07/2019.

¹³Saheli Roy Choudhury (2019, April 3). India's top court voided rules meant to resolve bad debt. That's not good for banks, Moody's says. *CNBC*, pp.1.

¹⁴Anonymous (2019, April 3). SC scraps Feb 12 RBI circular on bad loans: Impact and analysis. *Economics Times*. pp.1.

Pvt. Ltd. & Anr. V Union of India &Ors. Whereby it contemplated that the economic legislations are to be adjudged with considerable latitude.¹⁵

- VIRES OF THE FEBRUARY 12, 2018 CIRCULAR

The Apex Court made a significant outline of the edict of the Reserve Bank of India under Sections 35AA and 35AB, vindicating that when it comes to issuing directions to commence the insolvency resolution process under the Insolvency Code then Section 35AA is the exclusive source of power. Whereas, when it comes to issuance of directions with respect of stressed assets then such power falls within the scope of Section 35A peruse with Section 35AB.¹⁶ Hence, so far as the Reserve Bank of India had mandated banks to direct the debt dodgers to the Insolvency Court under the Code has constituted to an exercise of power under Section 35AA of the Act.

The Supreme Court had made it clear that the Reserve Bank of India can only mandate the banks to follow the Code if two conditions are satiated: firstly, there must be Central Government authorization and secondly, it should be with respect to specific defaults. The Section, however, proscribes this power from being exercised in any way other the manner provided under Section 35AA.

The Supreme Court held that the RBI's February 12 Circular was being ultra vires the Banking Regulation Act and the Reserve Bank of India Act and therefore, it was countermanded on the following grounds¹⁷:

- (i) The lack of Central Government's authorization behind the February 12 Circular renders its ultra vires Section 35AA of the Banking Regulation Act.
- (ii) The power of RBI to issue mandate (surmising government authorization) is restricted to specific defaults by specific debtors. The circular laid down the framework for all debt restructuring, therefore, it was general and not specific.
- (iii) There was nothing to show that the provisions of Section 45L(3) of the Reserve Bank of India Act have been fulfilled in issuing the impugned circular and henceforth, it falls foul of the same requirement under the Reserve Bank of India Act.¹⁸

CONCLUSION

The entire judgement was pivoted on the reading of the Section 35AA of the Banking Regulation Act. The Supreme Court upheld the constitutionality of the Section 35AA. The court indicated that there was nothing wrong with the section per se but what it finds fault with was the exercise of the power of the RBI under the said section.¹⁹ It is not the case that the RBI has no authority to modulate the defaulters of banks for

¹⁵Anonymous. Constitutional validity of the impugned circular issued by the RBI- Dharani Sugars and Chemicals Ltd. Vs. UOI &Ors.- SC. <https://ibclaw.in/constitutional-validity-of-the-impugned-circular-issued-by-the-rbi-dharani-sugars-and-chemicals-ltd-vs-uoi-ors-sc/> accessed 10/07/2019.

¹⁶Anonymous. Dharani Sugars and Chemicals Ltd. Vs Union of India &Ors, Supreme Court of India. https://www.sci.gov.in/supremecourt/2018/42591/42591_2018_Judgement_02-Apr-2019.pdf accessed 10/07/2019.

¹⁷Prachi Bhardwaj. SC declares February 2018 RBI Circular ultra vires. <https://blog.sconline.com/post/2019/04/02/213139/> accessed 10/07/2019.

¹⁸Anonymous. SC strikes down RBI's Feb 12 Insolvency Circular: Demystifying the Decision. <https://corplexia.com/sc-strikes-down-rbis-feb-12-insolvency-circular-demystifying-the-decision/> accessed 10/07/2019.

¹⁹Anonymous (2019. April 3). RBI gets a slap, big defaulters raise a cheer. *The Times of India*, pp.1.

Corporate Insolvency Resolution Process under the Code, but, the same is to be exercised within the constraints comprehended under Section 35AA of the Banking Regulation Act.²⁰

²⁰Abhirup Roy & Promit Mukherjee. India's top court quashes Central Bank Directive on resolving bad debt. <<https://www.reuters.com/article/us-india-debt/indias-top-court-quashes-central-bank-directive-on-resolving-bad-debt-idUSKCN1RE0OH>> accessed 10/07/2019.