

IBC DOSSIER

Bulletin on Landmark Judgments under IBC, 2016



M/s Pro Knits Vs. The Board of Directors of Canara Bank & Ors.

Brief Facts

In the present case, the appellants which included several MSMEs, challenged the High Court of Judicature at Bombay's ruling of January 11, 2024, which dismissed their writ petitions. The principal claim was that the respondent banks did not follow the restructuring process stated in the Notification dated May 29, 2015, before designating their loan accounts as Non-Performing Assets (NPAs). The core of the appeals was whether the Notification dated May 29, 2015, issued under Section 9 of the MSMED Act, required banks to comply before classifying MSME accounts as NPAs.

The appeals also questioned how the SARFAESI Act, particularly Section 35, which grants it overriding powers, would affect the MSME Notification's applicability.

Decision

The Supreme Court reiterated that the instructions for the "Framework for Revival and Rehabilitation of

MSMEs" established under the MSMED Act are indeed mandatory. The Notification required banks to identify incipient stress in MSME accounts by categorizing them as Special Mention Account (SMA) sub-categories before declaring them non-performing assets. This approach is intended to help MSMEs develop and compete more effectively.

While the SARFAESI Act establishes strong tools for the enforcement of security interests by secured creditors, the Supreme Court stated that the MSME framework must be followed before taking action under the SARFAESI Act. This means that the procedures for stress recognition and restructuring under the MSME Notification must come before the categorization of accounts as NPAs and any subsequent recovery efforts under the SARFAESI Act.

The judgment goes on to explain the relationship between the MSME framework and the Banking Regulation Act of 1949. Section 21 of the Banking Regulation Act authorizes the Reserve Bank of India (RBI) to monitor banking company advances and ensure compliance with its directives. The RBI's Master Directions, known as the "Reserve Bank of India [Lending to Micro, Small and Medium Enterprises (MSME) Sector] Directions, 2016," were issued under Sections 21 and 35A and were underlined as binding on all scheduled commercial banks.

The ruling rendered by the Supreme Court in support of the appellants, a group of MSMEs, emphasizes how important it is for MSMEs to have a structure in place for identifying and resolving financial stress prior to using the SARFAESI Act. This ruling establishes clear procedural guidelines for financial institutions while also strengthening the regulatory framework meant to assist MSMEs. Legal practitioners, whether representing MSMEs or financial institutions, need to carefully traverse these frameworks in order to protect their clients' interests.

This decision demonstrates the judiciary's dedication to ensuring that MSMEs' legislative protections are strictly implemented, in line with the MSMED Act's larger goals of competitiveness and economic development.

[Link of the Order](#)

<https://ibbi.gov.in/uploads/order/ae937442301533de8b1b2aa09d51a0e1.PDF>



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