Reportable

IN THE SUPREME COURT OF INDIA
CIVIL ORIGINAL JURISDICTION
WRIT PETITION (CIVIL) NO. 901 OF 2014

KESHAVLAL KHEMCHAND AND SONS PVT. LTD.
& OTHERS ... Petitioners

Versus

UNION OF INDIA & OTHERS ... Respondents

WITH

WRIT PETITION (C) NO. 902 OF 2014

WRIT PETITION (C) NO. 903 OF 2014

WRIT PETITION (C) NO. 904 OF 2014

WRIT PETITION (C) NO. 905 OF 2014

WRIT PETITION (C) NO. 907 OF 2014

WRIT PETITION (C) NO. 925 OF 2014

WRIT PETITION (C) NO. 926 OF 2014

WRIT PETITION (C) NO. 937 OF 2014

WRIT PETITION (C) NO. 938 OF 2014

WRIT PETITION (C) NO. 939 OF 2014

WRIT PETITION (C) NO. 940 OF 2014

WRIT PETITION (C) NO. 945 OF 2014

WRIT PETITION (C) NO. 946 OF 2014

WRIT PETITION (C) NO. 947 OF 2014

WRIT PETITION (C) NO. 948 OF 2014

CIVIL APPEAL NO. 1230 OF 2015
(Arising out of SLP (Civil) No.2230 of 2014)

CIVIL APPEAL NO. 1231 OF 2015
(Arising out of SLP (Civil) No.12008 of 2014)

CIVIL APPEAL NO. 1233 OF 2015
(Arising out of SLP (Civil) No.12153 of 2014)

CIVIL APPEAL NO. 1234 OF 2015
(Arising out of SLP (Civil) No.12233 of 2014)

CIVIL APPEAL NO. 1235 OF 2015
(Arising out of SLP (Civil) No.12266 of 2014)

CIVIL APPEAL NO.1236 OF 2015
(Arising out of SLP (Civil) No.12368 of 2014)

CIVIL APPEAL NO. 1237 OF 2015
(Arising out of SLP (Civil) No.12408 of 2014)

CIVIL APPEAL NO.1238 OF 2015
(Arising out of SLP (Civil) No. 12445 of 2014)

CIVIL APPEAL NO.1239 OF 2015
(Arising out of SLP (Civil) No.12461 of 2014)

CIVIL APPEAL NO.1240 OF 2015
(Arising out of SLP (Civil) No.12509 of 2014)

CIVIL APPEAL NO.1241 OF 2015
(Arising out of SLP (Civil) No.12584 of 2014)

CIVIL APPEAL NO.1242 OF 2015
(Arising out of SLP (Civil) No.12585 of 2014)

CIVIL APPEAL NO. 1243 OF 2015
(Arising out of SLP (Civil) No.12588 of 2014)

CIVIL APPEAL NO.1244 OF 2015
(Arising out of SLP (Civil) No.12589 of 2014)

CIVIL APPEAL NO.1245 OF 2015
(Arising out of SLP (Civil) No.12590 of 2014)

CIVIL APPEAL NO. 1246 OF 2015
(Arising out of SLP (Civil) No.12592 of 2014)

CIVIL APPEAL NO. 1247 OF 2015
(Arising out of SLP (Civil) No.12593 of 2014)

CIVIL APPEAL NO.1248 OF 2015
(Arising out of SLP (Civil) No.12594 of 2014)

CIVIL APPEAL NO.1249 OF 2015
(Arising out of SLP (Civil) No.12596 of 2014)

CIVIL APPEAL NOS.1250-1251 OF 2015
(Arising out of SLP (Civil) Nos. 13706-13707 of 2014)

CIVIL APPEAL NO.1252 OF 2015
(Arising out of SLP (Civil) No.14100 of 2014)

CIVIL APPEAL NO.1253 OF 2015
(Arising out of SLP (Civil) No.14259 of 2014)

CIVIL APPEAL NO.1254 OF 2015
(Arising out of SLP (Civil) No.14343 of 2014)

CIVIL APPEAL NOS.1255-56 OF 2015
(Arising out of SLP (Civil) Nos. 14345-14346 of 2014)

CIVIL APPEAL NO.1257 OF 2015
(Arising out of SLP (Civil) No.14358 of 2014)

CIVIL APPEAL NO.1258 OF 2015
(Arising out of SLP (Civil) No.14407 of 2014)

CIVIL APPEAL NO.1259 OF 2015
(Arising out of SLP (Civil) No.14518 of 2014)

CIVIL APPEAL NO.1260 OF 2015
(Arising out of SLP (Civil) No.14565 of 2014)

CIVIL APPEAL NO.1261 OF 2015
(Arising out of SLP (Civil) No.15076 of 2014)

CIVIL APPEAL NO.1262 OF 2015
(Arising out of SLP (Civil) No.15105 of 2014)

CIVIL APPEAL NO. 1263 OF 2015
(Arising out of SLP (Civil) No.15756 of 2014)

CIVIL APPEAL NO.1264 OF 2015
(Arising out of SLP (Civil) No.15818 of 2014)

CIVIL APPEAL NOS.1265-66 OF 2015
(Arising out of SLP (Civil) Nos.15835-15836 of 2014)

CIVIL APPEAL NOS. 1267-68 OF 2015

(Arising out of SLP (Civil) Nos.15837-15838 of 2014)

CIVIL APPEAL NOS. 1269-70 OF 2015
(Arising out of SLP (Civil) Nos.15841-15842 of 2014)

CIVIL APPEAL NO.1271 OF 2015
(Arising out of SLP (Civil) No.15963 of 2014)

CIVIL APPEAL NO.1272 OF 2015
(Arising out of SLP (Civil) No.15964 of 2014)

CIVIL APPEAL NO. 1273 OF 2015
(Arising out of SLP (Civil) No.16163 of 2014)

CIVIL APPEAL NO. 1274 OF 2015
(Arising out of SLP (Civil) Nos.16164 of 2014)

CIVIL APPEAL NO.1275 OF 2015
(Arising out of SLP (Civil) No.16165 of 2014)

CIVIL APPEAL NO.1276 OF 2015
(Arising out of SLP (Civil) No.18478 of 2014)

CIVIL APPEAL NO. 1277 OF 2015
(Arising out of SLP (Civil) No.18756 of 2014)

CIVIL APPEAL NO.1278 OF 2015
(Arising out of SLP (Civil) No.18949 of 2014)

CIVIL APPEAL NO. 1279 OF 2015
(Arising out of SLP (Civil) No. 21232 of 2014)

CIVIL APPEAL NO. 1280 OF 2015
(Arising out of SLP (Civil) No.22198 of 2014)

CIVIL APPEAL NOS. 1281-82 OF 2015
(Arising out of SLP (Civil) Nos. 24451-24452 of 2014)

CIVIL APPEAL NO. 1283 OF 2015
(Arising out of SLP (Civil) No. 25752 of 2014)

CIVIL APPEAL NO. 1284 OF 2015
(Arising out of SLP (Civil) No. 28796 of 2014)

CIVIL APPEAL NOS. 1285-86 OF 2015
(Arising out of SLP (Civil) Nos. 29722-29723 of 2014)

CIVIL APPEAL NO.1287 OF 2015
(Arising out of SLP (Civil) No.29792 of 2014)

CIVIL APPEAL NO. 1288 OF 2015
(Arising out of SLP (Civil) No. 30196 of 2014)

CIVIL APPEAL NO. 1289 OF 2015
(Arising out of SLP (Civil) No. 25444 of 2014)

CIVIL APPEAL NO. 1290 OF 2015
(Arising out of SLP (Civil) No. 25445 of 2014)

CIVIL APPEAL NOS. 1291-92 OF 2015
(Arising out of SLP (Civil) Nos. 32028-32029 of 2014)

AND

CIVIL APPEAL NO. 1293 OF 2015
(Arising out of SLP (Civil) No. 33096 of 2014)

J U D G M E N T

Chelameswar, J.

1. Leave granted in all the SLPs.

2. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (hereinafter referred to as the 'Act'), was made by the Parliament in the year 2002. The Statement of Objects and Reasons appended to the Act explained the purpose behind the enactment as follows:-

> "There is no legal provision for facilitating securitization of financial assets of banks and financial institutions. Further, unlike international banks, the banks and financial institutions in India do not have power to take possession of securities and sell them. Our existing legal framework relating to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms. This has resulted in slow place (*sic* pace) of recovery of defaulting loans and mounting levels of non-performing assets of banks and financial institutions."

The enactment was preceded by three Committee Reports – two headed by Mr. M. Narasimham[1] and the third by Mr. T.R. Andhyarujina[2].

3. Recovery of money from a debtor by resorting to the filing of a suit takes painfully long time in this country, for various reasons[3]. Huge amounts of money are lent by various banks and other financial institutions. Speedy recovery of the monies due to such institutions is an important element determining the efficiency not only of such institutions but also becomes an important factor for the financial health of the country.

4. In order to facilitate banks and financial institutions (hereinafter collectively referred to as "CREDITORS" for the sake of convenience) to speedily recover the monies due to them from the borrowers, Parliament made a law called 'The Recovery of Debts due to Banks and Financial Institutions Act, 1993' (51 of 1993) under which banks

[1] Ex. Governor, Reserve Bank of India
[2] Senior Advocate, Supreme Court of India
[3] 1.31 There has been a perception, and not without reason, that our legal system have not kept pace with measures of financial sector reform and indeed economic reforms more generally. As far as the banking sector is concerned, there is continuing need for an appropriate legal framework to help enforce contracts and protect the interests of secured creditors especially in bankruptcy proceedings. Some of our laws are outdated and legal procedures are cumbersome and time consuming. Even where Court decrees are obtained their enforcement has been marked by delays. Our experience with the Debt Recovery Tribunals has not been altogether satisfactory in view of the legal issues that have been raised. Our laws indeed seem marked by a basic asymmetry in their protection of creditors as distinct from borrowers which comes in the way of the proper and smooth functioning of banking and credit systems. [*See: Introduction : The Issues,* Report of the Committee on Banking Sector Reforms (April 1998), Ch.I page 6]

and financial institutions could approach a tribunal constituted under the said Act. It deals exclusively with the claims for the recovery of the monies due from the borrowers to the CREDITORS. Apart from creating such an exclusive forum, the Act also provided for a more simpler procedure for the adjudication of the legality of the claims brought before it by the CREDITOR and a procedure for speedy recovery of sums so adjudicated.

5. After a decade of working of the tribunals constituted under Act 51 of 1993, the Parliament felt that even machinery and procedure established under the Act 51 of 1993 is not able to produce the desired result of efficiently recovering monies from the borrowers. The Parliament, therefore, made the Act. The crux of the Act is that any 'security interest'[4] created in favour of a 'CREDITOR'[5], who by definition under the Act becomes a 'SECURED CREDITOR', can be enforced without the intervention either of the court or tribunal[6]

[4] Section 2(zf) "security interest" means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31;

[5] Section 2(zd) "secured creditor" means any bank or financial institution or any consortium or group of banks or financial institutions and includes—

(i) debenture trustee appointed by any bank or financial institution; or

(ii) securitisation company or reconstruction company, whether acting as such or managing a trust set up by such securitisation company or reconstruction company for the securitisation or reconstruction, as the case may be; or

(iii) any other trustee holding securities on behalf of a bank or financial institution in whose favour security interest is created for due repayment by any borrower of any financial assistance;

[6] Section **13. Enforcement of security interest.-** (1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882 (4 of 1882), any security interest created in favour of any secured creditor may

constituted under Act 51 of 1993 by following the procedure under Section 13 of the Act. Section 13(2) of the Act provides as follows:

> "(2) Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4)."

6. It provides that the SECURED CREDITOR may call upon the borrower[7], by issuing a notice in writing to discharge his liabilities in full within a period of sixty days from the date of the notice. If the borrower fails to discharge his liabilities after such a demand, the secured creditor is entitled to take any one of the steps contemplated under Section 13(4). Sub-section (2) also stipulates three conditions precedent for the issuance of such notice – (i) that the borrower must have a liability under a 'security agreement'[8]; (ii) that the borrower made a default in repayment of the debt or the instalment thereof;

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be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.

[7] Section 2(f) "borrower" means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance;

[8] Section 2(zb) "security agreement" means an agreement, instrument or any other document or arrangement under which security interest is created in favour of the secured creditor including the creation of mortgage by deposit of title deeds with the secured creditor;

and (iii) that the account in respect of such debt is classified by the secured creditor as a 'non-performing asset' (hereinafter referred to as "NPA")

7. Sub-section (3) stipulates[9] that notice referred to in sub-section (2) shall give the details of the amounts payable by the borrower and details of the secured assets intended to be enforced by the secured creditor in the event of borrower not complying with the demand made in the notice.

8. Sub-section (4) provides that in the event of the borrower failing to discharge his liability in spite of notice under sub-section (2), the secured creditor may take recourse to any one or more of the measures indicated under sub-section 13(4)[10].

[9] **Section 13(3)** - The notice referred to in sub-section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.

[10] Section 13(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:--

(a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

(b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset:

PROVIDED that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:

PROVIDED FURTHER that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security or the debt.

(c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;

(d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

9. Another important aspect of the Act is that the activity of the Securitisation Companies (SC) and Reconstruction Companies (RC) are given a statutory recognition. Their activity is regulated under Sections 3 and 4 of the Act. Under Section 3 such companies are required to be registered with the RBI. Such registration is liable for cancellation under Section 4 on the happening of any one of the events specified therein. Section 5 confers statutory authority upon SCs and RCs to acquire the "financial assets"[11] of any CREDITOR. Section 5(2)[12] further provides that upon such acquisition of an asset, the SC or RC, as the case may be, steps into the shoes of the original SECURED CREDITOR from whom the asset is acquired.

10. Under the Act, SCs and RCs are also treated to be SECURED CREDITORS by definition. [*See* Section 2(1)(zd)]

[11] 2(1)(l) "financial asset" means debt or receivables and includes-
(i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or
(ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or
(iii) a mortgage, charge, hypothecation or pledge of movable property; or
(iv) any right or interest in the security, whether full or part underlying such debt or receivables; or
(v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
(vi) any financial assistance;

[12] 5(2) If the bank or financial institution is a lender in relation to any financial assets acquired under sub-section (1) by the securitisation company or the reconstruction company such securitisation company or reconstruction company shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.

11. The constitutional validity of the Act was examined by this Court in ***Mardia Chemicals Ltd. & Others*** *v.* ***Union of India & Others***, (2004) 4 SCC 311. This Court upheld the constitutionality of the Act except that of sub-section (2) of Section 17.

> "82. We, therefore, subject to what is provided in para 80 above, uphold the validity of the Act and its provisions except that of sub-section (2) of Section 17 of the Act, which is declared *ultra vires* Article 14 of the Constitution of India."

12. One of the grounds on which the Act was challenged in ***Mardia Chemicals*** (supra) was that the said Act enables the SECURED CREDITORS to classify the account of a borrower as NPA at the whims and fancies of such SECURED CREDITORS. This Court rejected the said submission for the reasons that the guidelines laid down by the Reserve Bank of India for classifying the account of a borrower as a NPA would eliminate the possibility of the SECURED CREDITOR arbitrarily declaring the account of a borrower as a NPA.

> "37. Next we come to the question as to whether it is on the whims and fancies of the financial institutions to classify the assets as non-performing assets, as canvassed before us. We find it not to be so. As a matter of fact a policy has been laid down by Reserve Bank of India providing guidelines in the matter for declaring an asset to be a non-performing asset known as "RBI's prudential norms on income recognition, asset classification and provisioning – pertaining to advances" through a circular dated 30-8-2001. It is mentioned in the said circular as follows:
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> **** **** **** ****
> **** **** **** ****

> From what is quoted above, it is quite evident that guidelines as laid down by Reserve bank of India which are in more details but not necessary to be reproduced here, lay down the terms and conditions and circumstances in which the debt is to be classified as non-performing asset as clearly as possible. Therefore, we find no substance in the submission made on behalf of the petitioners that there are no guidelines for treating the debt as a non-performing asset."

13. Section 2(1)(o) of the Act defines NPA. The said definition came to be amended by Act 30 of 2004. It is the amended definition which is the subject matter of dispute in this bunch of matters. The said amended definition came to be challenged in various High Courts.

14. The High Court of Gujarat, by a common judgment dated 24.4.14 in a batch of writ petitions, held that the amended Section 2(1)(o) of the Act is unconstitutional.

> "55. In view of the above-discussions, the writ application is partly allowed by holding that the amended provisions of Section 2(1)(o) of the Securitisation Act are *ultra vires* the Article 14 of the Constitution and the object of the above Act itself and consequently, we restore the provisions which existed earlier, i.e., prior to the amendment of 2004 and existed at the time of decision of the Supreme Court in the case of ***Mardia Chemicals*** (supra). We, however, uphold the guidelines of the RBI challenged in this application."

15. On the other hand, in another common judgment dated 18.5.14 in a batch of writ petitions, the Madras High Court rejected the challenge.

16. Hence these appeals by the various aggrieved parties, either the borrowers or the SECURED CREDITORS. Various writ petitions invoking Article 32 of the Constitution also came to be filed by some borrowers against whom proceedings under Section 13 of the Act were initiated during the pendency of the appeals from the two judgments referred to above.

17. Since the bone of contention in this bunch of matters is the amended Section 2(1)(o) of the Act, we deem it appropriate to extract the provision as it existed both prior to and after the amendment.

THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002	THE ENFORCEMENT OF SECURITY INTEREST AND RECOVERY OF DEBTS LAWS (AMENDMENT) ACT, 2004
2. Definitions (1) In this Act, unless the context otherwise requires: (o) "Non-Performing Asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss assets, in accordance with the directions or under guidelines relating to assets classification issued by the Reserve Bank.	2. Definitions (1) In this Act, unless the context otherwise requires: (o) "Non-Performing Asset" means an asset or account of a borrower, which has been classified by a bank or financial institution, as sub-standard, doubtful or loss asset.- (a) In case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or

	body; (b) In any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank.

18. It can be seen from the above, that prior to its amendment by Act 30 of 2004, NPA is defined as 'an account of a borrower which has been classified' by a CREDITOR either 'as a sub-standard asset or a doubtful asset or a loss asset' of the CREDITOR and such a classification is required to be made in accordance with the directions or guidelines relating to assets classification issued by the Reserve Bank.

19. But, under the amended definition, such a classification of the account of a borrower by the CREDITOR is required to be made in accordance with the directions or guidelines issued by an "authority or body either established or constituted or appointed by any law for the time being in force", in all those cases where the CREDITOR is either administered or regulated by such an authority (hereinafter referred to as the "REGULATOR"). If the CREDITOR is not administered or regulated by any such REGULATOR then the CREDITOR is required to classify the account of a borrower as NPA in

accordance with the guidelines and directions issued by the Reserve Bank of India.

20. In other words, by the amendment, the Parliament made it possible that different sets of guidelines made by different bodies may be followed by different CREDITORS depending upon the fact as to who is the administering or regulating authority of such CREDITOR. Hence, the challenge to the amended provision.

21. Before we examine the various submissions made at the Bar, we deem it appropriate to give a brief analysis of the judgments of the Madras High Court as well as the Gujarat High Court.

22. The High Court of Madras rejected the submission of the petitioners that the impugned provision suffers from the *vires* of excessive delegation.

(a) The High Court took note of the fact that the Reserve Bank of India introduced in the year 1992 the prudential norms of “income recognition, asset classification, provisioning and other related

matters" and such norms were revised periodically keeping in mind various developments in the banking system, both nationally and internationally. The High Court took note of the practice of the Reserve Bank of issuing master circulars annually which contain the consolidated instructions issued by the Reserve Bank from time to time on the above-mentioned matters.

(b) The High Court took note of the fact that the Reserve Bank of India in exercise of the statutory authority under Section 21 and Section 35A of the Banking Regulation Act, 1949 prescribes norms for the various aspects of banking specified under the Act.

(c) The High Court held that the Parliament, while defining a non-performing asset under Section 2(1)(o) of the Act, only adopted the norms prescribed from time to time by the Reserve Bank of India for the purpose of identifying the NPA.[13]

> "34.....In this case, the Legislature has left the job of defining "non-performing asset' in the hands of Reserve Bank of India. Therefore, when once the Legislature has approved the power of Reserve Bank

[13] 29. However, the question for consideration before us is as to whether there is indeed any delegated legislation or not. We are of the view that there is no delegated legislation involved in the case on hand. As discussed above, the power exercised by the Reserve Bank of India in a separate enactment has been taken note of by the Legislature in the subsequent one. It is only a definition clause, which has been adopted by the Legislature. This has been done to put its machinery into use towards its avowed object of activity – appropriate recovery. Therefore, we do not find any delegated legislation involved and therefore contentions raised on the power of delegation and thereafter it is excessive, has no force. We only observe for the sake of completion, that even assuming that there is a delegated legislation involved, the same is not excessive as there are sufficient guidelines available in the earlier enactment and based upon which the Circular has been issued by the Reserve Bank of India, being a specialized body.

> of India on the classification of assets, the resultant consequence would be that a subsequent amendment pertaining to such a classification would apply with its vigour and force to the new Act as well.
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> 35. In the light of the discussions made above, we are of the view that it is a case of an adoption involved in the present case. Therefore it can only be termed as legislation by reference and hence the impugned Circular is valid in law."

23. On the other hand, the Gujarat High Court opined that the amended definition of the expression 'NPA' creates two classes of borrowers. In the context of the classification of the account of a borrower as a NPA of the CREDITOR, while one class of borrowers are governed by the guidelines issued by the Reserve Bank of India, the other class of borrowers are governed by the guidelines issued by different authorities.[14] The High Court also placed reliance on the statement of objects and reasons of the Act, as it was originally enacted, which *inter alia* stated as:

> "(h) empowering banks and financial institutions to take possession of securities given for financial assistance and sell or lease the same or take over management in the event of default, i.e. classification of the borrower's account as non-performing asset in accordance with the directions given or guidelines issued by the Reserve Bank of India from time to time."

and recorded a conclusion that the Parliament deviated from the original aims and objects propounded by it. It also took note of the

[14] 23. Thus, borrowers are divided into two different classes; First, the borrowers in respect of the Banks and Financial Institutions which are administered or regulated by an authority or body established, constituted or appointed by any law for the time being in force, and in those cases, it will be for that authority or body to frame the guidelines for asset classification and, secondly, the borrowers in respect of all other cases not covered by clause (a), and in respect of those cases, it will be in accordance with the directions or guidelines issued by the Reserve Bank for asset classification.

fact that this Court in ***Mardia Chemicals*** (supra) repelled the attack on the original definition of a NPA on the ground that the CREDITORS are bound by the policy guidelines issued by the Reserve Bank of India, and therefore, there is no possibility of the CREDITORS arbitrarily or whimsically classifying the account of any borrower as a NPA.

The High Court therefore opined that the deviation from the original objects and reasons would be violative of Article 14 of the Constitution of India.

24. Learned counsel appearing for the borrowers argued that the amended Section 2(1)(o) is unconstitutional for the following reasons:

(1) that the Parliament, by authorizing the various bodies to frame the guidelines in accordance with which the account of a borrower could be classified as a NPA abdicated its essential legislative function by making an excessive delegation;

(2) that while the un-amended Section 2(1)(o) provided for a uniform standard by which an account of a borrower is to be classified as NPA of the CREDITOR by applying the guidelines issued by the Reserve Bank, the amended provision enables different

CREDITORS to adopt different guidelines which prescribe different standards for arriving at a conclusion that the account of a borrower is NPA. Such a provision according to the borrowers, is violative of Article 14 of the Constitution of India as it amounts to a class legislation forbidden by Article 14;

(3) Since the Act recognizes the possibility of acquisition of a "financial asset"[15] of a CREDITOR by either a "securitization company"[16] or a "reconstruction company"[17] it introduces a great deal of uncertainty in the matter of the application of the guidelines appropriate for classification of an account of a borrower as a NPA. It all depends on the fact as to who is the current holder of such financial asset when the proceedings under Section 13 are sought to be invoked.

[15] Section 2. Definitions— (1) In this Act, unless the context otherwise requires,-- (l) "financial asset" means debt or receivables and includes--
(i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or
(ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or
(iii) a mortgage, charge, hypothecation or pledge of movable property; or
(iv) any right or interest in the security, whether full or part underlying such debt or receivables; or
(v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
(vi) any financial assistance;

[16] Section 2(za) "securitisation company" means any company formed and registered under the Companies Act, 1956 (1 of 1956) for the purpose of securitisation;

[17] Section 2(v) "reconstruction company" means a company formed and registered under the Companies Act, 1956 (1 of 1956) for the purpose of asset reconstruction;

(4) As the Act does not provide for a reasonable opportunity to demonstrate that the classification of the borrower's account as a NPA is untenable, the power to make such a classification itself becomes arbitrary and violative of Article 14 of the Constitution.

25. On the other hand, the learned counsel appearing for the Union of India, the RBI and the various CREDITORS submitted that the impugned amendment is a constitutionally valid piece of legislation.

1. In recognition of the fact that the assessment of an account of borrower as NPA depends upon innumerable factors which constantly keep changing, Parliament thought it fit to stipulate that the assessment be made in the light of the guidelines made by either the RBI or various other REGULATORS regulating the activities of various CREDITORS. There is no delegation of any essential legislative functions.

2. The prescription that the classification of NPA is to be made on the basis of the guidelines framed by different bodies regulating the different CREDITORS is a constitutionally permissible classification having regard to the nature of the different credit

facilities extended by the various CREDITORS to different categories of borrowers and on different terms and conditions.

3. The third submission made on behalf of the borrowers is sought to be repelled on two grounds:

i) that, it is a purely hypothetical submission in the context of the present set of cases as in none of the cases the original SECURED CREDITOR transferred the financial asset in favour of any other body;

ii) assuming for the sake of argument that there is a possibility of an asset of the SECURED CREDITOR being acquired either by a securitization company or a reconstruction company and therefore are governed by the guidelines (for the determination of the question whether an acquired asset has become a non-performing asset) other than those promulgated by the Reserve Bank of India, it has not been demonstrated in any one of these cases that such guidelines are less favourable to the borrowers than the guidelines of the Reserve Bank of India.

26. We would like to make it clear that we are not undertaking the examination of a second round of attack on the constitutionality of the Act in its entirety. It is nobody's case that judgment of this Court in ***Mardia Chemicals*** (supra) requires reconsideration. As pointed out by the borrowers, the definition of the expression "NPA" [under Section 2(1)(o)] underwent an amendment subsequent to the decision in ***Mardia Chemicals***, the validity of such an amendment only is required to be examined in these matters.

27. We have already noticed that under Section 13 of the Act the right to invoke the provisions of the Act for enforcement of a security interest is permissible only on the satisfaction of the three conditions specified under Section 13(2) of the Act. One of them being that the account of the borrower is classified by the SECURED CREDITOR as a non-performing asset (NPA) of the CREDITOR.

28. The expression 'asset' is not defined under the Act. But the expressions 'financial asset'[18] and 'non performing asset' are defined under Section 2(1)(l) and 2(1)(o) of the Act. The claim of a CREDITOR to any debt or receivables etc. from the borrower becomes the

[18] Footnote 11 supra

financial asset of the CREDITOR. Under the unamended definition, an asset (of the CREDITOR i.e., the account of the borrower) which is classified by the CREDITOR as "sub-standard, doubtful or loss asset" in accordance with the direction or guidelines relating to the assets classification issued by the Reserve Bank becomes an NPA. The amended definition however defines a NPA as an asset classified by the CREDITOR as "sub-standard, doubtful or loss asset" in accordance with the relevant guidelines issued by the appropriate body. In the case of the CREDITORS "administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force", such 'REGULATOR', and with reference to CREDITORS, not so administered or regulated, the Reserve Bank are the appropriate authorities.

29. We have already noticed that one of the two main purposes of the Act is to facilitate the SECURED CREDITORS[19] to recover the

[19] The expression "SECURED CREDITOR" by definition under the Act takes within its sweep – (i) a bank, (ii) a financial institution, consortium or group of banks or financial institutions, (4) debentures trustees appointed by any bank or financial institution, (5) a securitisation company, (6) reconstruction company etc. Once again the expression 'bank' by definition takes within its sweep six categories of entities specified under Section 2(1)(c). The expression 'financial institution', by definition under the Act, takes within its sweep four categories of bodies specified under Section 2(1)(m). The activities of all the above mentioned categories of entities are primarily governed by some in-house managerial body which, in turn, are subject to the control and regulation either by the Reserve Bank of India or some other statutory body or authority, which are also subject to the overall supervisory control of the Reserve Bank of India. For example, the National Housing Bank, a bank established under the Act No.53 of 1987 of the Parliament, though is an autonomous body "to operate as a financial agency to promote housing finance institutions" with vast powers to regulate the housing finance activity in the country, it is still obliged under Section 5(5) of the Act 53 of 1987 to be guided by the directions given by the Reserve Bank of India.

amounts due to them from the borrowers by enforcing the security interest created by the borrowers without the intervention of the civil court or the tribunal.

30. We think that it is necessary to trace out the history of the concepts of (i) NPA and (ii) loan transaction for the better appreciation of the controversy before us.

31. On 14th August, 1991, the Government of India appointed a nine-member Committee headed by Mr. M. Narasimham, (13th Governor of the Reserve Bank of India) to examine various aspects relating to the structure, organization, functions and procedures of the banking system. The said Committee came to be appointed in the backdrop of the Balance of Payment Crisis which the country was facing at that point of time.

32. The Committee submitted its 1st Report on the 16th November, 1991. While examining the various aspects of the financial system,

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The National Housing Bank Act, 1987 (No.53 of 1987) - Section 5(5). In the discharge of its functions under this Act, the National Housing Bank shall be guided by such directions in matters of policy involving public interest as the Central government, in consultation with the Reserve Bank, or the Reserve Bank, may give in writing.

We are informed at the bar by the learned counsel appearing for the Reserve Bank of India that there are some 49 entities (we doubt the accuracy of the statement but it does not make any difference for this decision on hand), such as, 18 State Financial Corporations, Exim Bank, National Housing Bank, NABARD etc., which fall within the definition of the expression "bank" or "financial institution" as defined under the SARFAESI Act which fall within the sweep of Section 2(1)(o)(a) of the said Act.

the said Committee considered the functioning of the banking system in the country. It took note of the existing guidelines issued by the Reserve Bank of India from time to time and also the various practices of the banking industry. The Committee was of the view that the "ratio of capital funds in relation to bank's deposits or its assets is a well known and universally accepted measure of the strength and stability of the institution".

33. It took note of the capital adequacy standards prescribed by the Committee known as Basle Committee[20] and opined that it is necessary that the Indian banks also conform to those standards. But as a prelude to the compliance with the BIS standards, the Committee opined that the banks should have their assets revalued on a more realistic basis and on the basis of their realizable value.

34. It also took note of the fact that the banks and development financial institutions (DFIs) had not been following a universal practice with regard to the income recognition, valuation of investments or

[20] The Basle Committee on Banking Regulations and Supervisory Practices appointed by the Bank of International Settlements (BIS) has prescribed certain capital adequacy standards to be followed by commercial banks and these standards have been accepted for implementation by several countries. The BIS standard, as it is popularly known, seeks to measure capital adequacy as the ratio of capital to risk weighted assets. It has prescribed weightages for different categories of assets which include certain off-balance sheet items as well. The Committee believes that it is necessary that banks in India also conform to these standards in a phased manner. [*See: Capital Adequacy, Accounting Policies and Other Related Matters,* Report of the Committee on the Financial System (November 1991), Ch.V page 51]

provisioning against doubtful debts. It is in this background, the Committee recommended as follows:-

"..The international practice is that an asset is treated as "non-performing" when interest is overdue for at least two quarters. In respect of such non-performing assets interest is not recognized on accrual basis but is booked as income only when actually received. The Committee is of the view that a similar practice should be followed by banks and financial institutions in India and accordingly recommends that interest on non-performing assets should not be booked as income on accrual basis. The non-performing assets would be defined as an advance where, as on the balance sheet date

(a) in respect of term loans, interest remains past due for a period of more than 180 days.

(b) in respect of overdraft and cash credits, accounts remain out of order for a period of more than 180 days,

(c) in respect of bills purchased and discounted, the bill remains overdue and unpaid for a period of more than 180 days,

(d) in respect of other accounts, any amount to be received remains past due for a period of more than 180 days.

An amount is considered <u>past due</u> when it remains outstanding 30 days beyond the date.

**** **** **** ****

The Committee is of the view that for the purposes of provisioning, banks and financial institutions should classify their assets by compressing the Health Codes into the following broad groups:

i) Standard
ii) Sub-standard
iii) Doubtful and
iv) Loss

The RBI should prescribe clear and objective definitions for these 4 categories to ensure a uniform, consistent and logical basis for classification of assets. Broadly stated, sub-standard assets would be those which exhibit problems and would include assets classified as non-performing for a period not exceeding two years. Doubtful assets are those non-performing assets which remain as such for a period exceeding two years and would also include loans in respect of which instalments are overdue for a period exceeding 2 years. Loss assets are

accounts where loss has been identified but the amounts have not been written off."

35. Narasimham Committee Report on asset classification by the CREDITORS was accepted by the Reserve Bank of India and guidelines are being issued from time to time. Different instructions culminating into different "Master Circulars" with respect to various classes of banks and financial institutions came to be issued by the Reserve Bank from time to time. For example, the Reserve Bank of India issued instructions dealing with the Non Banking Financial Companies (NBFCs)[21] and also the Securitisation Companies and Reconstruction Companies. Originally such guidelines were meant only to enable the CREDITORS to have a rational view of their "assets"/"financial assets" for the better administration of their funds and the banking business. The Parliament thought it fit to adopt the above-mentioned guidelines issued by the Reserve Bank of India even for the purpose of identifying NPAs under the Act.

[21] Section 45-I(f) ''non-banking financial company'' means–
(i) a financial institution which is a company;
(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

36. Now, we proceed to examine what exactly is a loan transaction – the rights and obligations arising out of a loan transaction and the impact of the Act on such rights and obligations.

37. The expression 'loan', though not defined under the Act, has a well-settled connotation i.e., advancing of money by one person to another under an agreement by which the recipient of the money agrees to repay the amount on such agreed terms with regard to the time of repayment and the liability to pay interest.

> "**Definition of loan**. A contract of loan of money is a contact whereby one person lends or agrees to lend a sum of money to another, in consideration of a promise express or implied to repay that sum on demand, or at a fixed or determinable future time, or conditionally upon an event which is bound to happen, with or without interest."
>
> - Chitty on Contracts, Vol.II 30th Edn., p.909

38. The person advancing the money is generally called a CREDITOR and the person receiving the money is generally called a borrower. The most simple form of a loan transaction is a contract by which the borrower agrees to repay the amount borrowed on demand by the creditor with such interest as stipulated under the agreement. Such a loan transaction may be attended by any arrangement of a security like a mortgage or pledge etc. depending upon the agreement of the parties.

39. The Act provides for a mode of speedy recovery of the monies due from the borrowers to one class of creditors who are banks and financial institutions (CREDITORS). Advances/loans made by CREDITORS to businessmen and industrialists are generally not repayable on demand but repayable in accordance with a fixed time schedule agreed upon by the parties known as "term loans".

> "**Term loans**. A loan may be made for a specified period (a term loan). In such a case repayment is due at the end of the specified period and, in the absence of any express provision or implication to the contrary, no further demand for repayment is necessary."
> - Chitty on Contracts, Vol.II 30th Edn., p.913

In other words, such loans are repayable in instalments over a period of time the terms of which are evidenced by a written agreement between the parties. A default in the repayment, (in terms of the agreed schedule) generally provides a cause of action for the CREDITOR to initiate legal proceedings for the recovery of the entire amount due and outstanding from the borrower. Normally such term loans are also accompanied by some 'security interest' in a 'secured asset' of the borrower. Such a recovery is to be made normally by instituting a suit for recovery of the amounts by enforcing the 'security interest'. The Recovery of Debts due to Banks and Financial Institutions Act, 1993 created an exclusive forum for a speedy ascertainment of the amounts actually due from the defaulting

borrower and also provided for a mechanism for speedy recovery of the amounts so ascertained from such borrowers.

40. Since such a system was also found to be inadequate for the speedy recovery of the monies due from the borrowers to the CREDITORS, the Parliament made the Act under which the process of ascertainment of the amounts due from a borrower by an independent adjudicatory body is dispensed with. The SECURED CREDITOR is made the sole judge of the amount due and outstanding from a borrower subject to an appeal under Section 17 of the Act.

41. Be that as it may, such an ascertainment of amount due and outstanding is not the only criteria on the basis of which the SECURED CREDITOR is entitled to initiate proceedings under Section 13(4) of the Act, but the SECURED CREDITOR is also required to classify the account of the borrower (asset of the CREDITOR) as an NPA.

42. *De hors* the Act, when the borrower of a term loan defaults in the repayment, the CREDITOR can initiate legal proceeding straight away for recovery of the amounts due and outstanding from the borrower. The Act places an additional legal obligation on the CREDITOR to

examine and decide whether the account of the borrower has become an NPA before initiating action under the Act.

43. The question – why did the Parliament impose such an additional obligation on the CREDITORS while proposing to create a mechanism for the expeditious recovery of the money due to the SECURED CREDITORS – requires examination. The answer appears to be that under the scheme of Section 13(4) the 'secured asset' (generally the assets of an industrial concern, like plant and machinery etc.) could be taken possession of and could either be sold or the management could be taken over etc. Such an action if not taken after an appropriate deliberation in a given case could result in the disruption of industrial production and consequently resulting in unemployment and loss of GDP etc. impacting larger interests of the nation. Therefore, Parliament must have thought that the SECURED CREDITORS are required to assess whether the default in repayment by the borrower is due to any factor which is a temporary phenomenon and the same could be managed by the borrower if some accommodation is given.

44. The above analysis of the scheme of Section 13 of the Act would derive support from the fact that even prior to the coming into force of the Act, the CREDITORS were classifying the accounts of the borrowers as NPAs under the statutory guidelines issued by the RBI. We have already noticed that under the said guidelines FINANCIAL ASSETS are sub-divided into 4 categories i.e. (i) standard, (ii) sub-standard, (iii) doubtful, and (iv) loss. Depending upon the length of the period for which the installment of money is over due, such assets are classified as NPA. As the length of the period of over due increased, the account of the borrower is progressively classified from "sub-standard" to "loss".

45. The same classification is adopted by the Parliament while enacting the Act. Therefore, all NPAs do not belong to the same class. Their characters vary depending on the length of time for which they remained NPAs.

46. In our view, such a classification is relevant and assumes importance in the decision making process of the SECURED CREDITOR under Section 13(2) as to which one of the steps contemplated under Section 13(4) should be resorted to in the case of a given defaulting

borrower. We hasten to add that it may not be the only factor which determines the cause of action to be taken by the SECURED CREDITOR. The magnitude of the amount due and outstanding in a given case, the reasons which prompted the borrower to default in the repayment schedule, the nature of the business carried on by the defaulting borrower, the overall prospects of the defaulter's business, national and international market conditions relevant to the business of a defaulter – in our opinion, are some of the factors which are germane to a decision that action under Section 13(4) is required to be taken against a defaulting borrower. Even in a case where on rational and objective consideration of all the relevant factors including the representations/objections referred to under Section 13(3A), the CREDITOR comes to a conclusion that steps contemplated under Section 13(4) are required to be taken in the case of a particular defaulter, the further question as to which one of the steps contemplated under Section 13(4) is required to be taken or would meet the ends of justice is a matter for a further rational decision on the part of the SECURED CREDITOR.

47. The international practice - noted by Narasimham Committee – is that “an asset is treated as non-performing when interest is overdue for at least two quarters”. Such a practice of classifying the asset for the administrative purposes of the Banks only indicates that a borrower’s account is not treated as a written off asset, the moment there is a default. CREDITORS keep a watch on such account and monitor the performance of the borrower’s activity to ensure the recovery of the amounts due having regard to the needs of the industrial sector of the country and the importance of protecting the industry as far as possible in the larger interest of the economy of the State.

48. The basic definition under the various circulars of the Reserve Bank of India and also other REGULATORS of a NPA is an asset which ceases to generate income for the CREDITORS (banks or financial institutions) i.e. a loan or advances made by the banks on which interest and/or instalment of principal amount is overdue for a specified period depending upon the nature of the loan or advance - whether the loan or advance is a term loan or agricultural loan, money advanced on bill discounting etc.

49. To make any attempt to define the expression 'non-performing asset' valid for the millions of cases of loan transactions of various categories of loans and advances, lent or made by different categories of CREDITORS for all time to come would not only be an impracticable task but could also simply paralyse the entire banking system thereby producing results which are counter productive to the object and the purpose sought to be achieved by the Act.

50. Realising the same, the Parliament left it to the Reserve Bank of India and other REGULATORS to prescribe guidelines from time to time in this regard. The Reserve Bank of India is the expert body to which the responsibility of monitoring the economic system of the country is entrusted under various enactments like the RBI Act, 1934, the Banking Regulation Act, 1949. Various banks like the State Bank of India, National Housing Bank, which are though bodies created under different laws of Parliament enjoying a large amount of autonomy, are still subject to the overall control of the Reserve Bank of India.

51. Regulation of monetary system and banking business is one of the fundamental responsibilities of any modern State and essential for the economic and political stability of the State. The vast increase of commerce both national and the international made easy by the tremendous developments of technology, renders such regulation a very complicated matter with complex variables. The span of each variable could vary from minutes to years. Therefore, it requires constant monitoring on daily basis sometime even on minute to minute basis. In lieu of the importance and complexities, the Reserve Bank, the prime regulator of the Indian economy and banking system, has been issuing guidelines and directions from time to time not only to the banks but to various other financial institutions which are amenable to its jurisdiction. Such instructions given from time to time are consolidated annually and published in the form of "Master Circulars". One of such circular dated 30.08.2001 was taken note of by this Court in ***Mardia Chemicals***. Incidentally, the authority of the Reserve Bank to issue such instructions was considered by this Court in ***ICICI Bank Limited*** *v.* ***Official Liquidator of APS Star Industries Limited & Others***, (2010) 10 SCC 1, and this Court held

that the Reserve Bank did have such authority by virtue of Sections 21 and 35-A of the Banking Regulation Act, 1949[22].

52. The question is whether in making such a prescription, the Parliament has delegated any essential legislative function? To answer the question it is required to understand what is an essential legislative function and what are the limits subject to which such function could be delegated.

53. The first major decision of this Court on the subject of the validity of delegated legislation is ***In re Art. 143, Constitution of India and Delhi Laws Act (1912) etc.***, AIR 1951 SC 332, by a Constitution bench of 7-Judges. Seven separate judgments were delivered. It was a case where Section 7 of the Delhi Laws Act authorized the provincial government to extend by a notification in the official gazette to the provinces of Delhi, any enactment which was in force in any part of British India as on the date of such notification. Similar provisions were contained in two other enactments. One of the questions was whether such conferment of power on the executive amounted to

[22] "39. The Guidelines issued by RBI dated 13.7.2005 itself authorizes the banks to deal *inter se* in NPAs. These guidelines have been issued by the regulator in exercise of the powers conferred by Sections 21 and 35-A of the Act. ……. All this comes within the ambit of Section 21 which enables RBI to frame the policy in relation to advances to be followed by the banking companies under Section 21(2). These guidelines and directions following them have a statutory force."

excessive delegation of the legislative power. Even according to Patanjali Sastri, J., who was a member of the Bench which decided the case, in a subsequent decision in ***Kathi Raning Rawat*** *v.* ***State of Saurashtra***, AIR 1952 SC 123, while dealing with the decision in ***Delhi Laws Act's case*** observed thus:

> "While undoubtedly certain definite conclusions were reached by the majority of the Judges who took part in the decision in regard to the constitutionality of certain specified enactments, the reasoning in each case was different, and it is difficult to say that any particular principle has been laid down by the majority which can be of assistance in the determination of other cases.".

54. In the case of ***B. Shama Rao*** *v.* ***Union Territory of Pondicherry***, AIR 1967 SC 1480, J.M. Shelat, J. speaking for majority (3) of a Constitution Bench of 5 Judges, after summarizing the views of the 7-Judges who delivered the judgment in ***Delhi Laws Act's*** case opined;

> "5. …….In view of the intense divergence of opinion except for their conclusion partially to uphold the validity of the said laws it is difficult to deduce any general principle which on the principle of stare decisis can be taken as binding for future cases. It is trite to say that a decision is binding not because of its conclusion but in regard to its ratio and the principle laid down therein. The utmost, therefore, that can be said of this decision is that the minimum on which there appears to be consensus was (1) that legislatures in India both before and after the Constitution had plenary power within their respective fields; (2) that they were never the delegates of the British Parliament; (3) that they had power to delegate within certain limits not by reason of such a power being inherent in the legislative power but because such power is recognised even in the United States of America where separatist ideology prevails on the ground that it is necessary to effectively exercise the legislative power in a modern State with multifarious activities and complex problems facing legislatures; and (4) that delegation of an essential legislative function which amounts to abdication even partial is not permissible. All of them were agreed that it could be in respect of subsidiary and ancillary power."

55. In ***Devi Das Gopal Krishnan etc.*** *v.* ***State of Punjab & Others***, AIR 1967 SC 1895, another Constitution Bench though struck down the impugned provision on the ground of excessive delegation, recognized the need of delegating and this Court opined as follows:-

> "…… But in view of the multifarious activities of a welfare State, it cannot presumably work out all the details to suit the varying aspects of a complex situation. It must necessarily delegate the working out of details to the executive or any other agency. But there is danger inherent in such a process of delegation. An over-burdened legislature or one controlled by a powerful executive may unduly overstep the limits of delegation. It may not lay down any policy at all; it may declare its policy in vague and general terms; it may not set down any standard for the guidance of the executive; it may confer an arbitrary power on the executive to change or modify the policy laid down by it without reserving for itself any control over subordinate legislation. Thus self effacement of legislative power in favour of another agency either in whole or in part is beyond the permissible limits of delegation. It is for a court to hold on a fair, generous and liberal construction of an impugned statute whether the legislature exceeded such limits.
>
> But the said liberal construction should not be carried by the courts to the extent of always trying to discover a dormant or latent legislative policy to sustain an arbitrary power conferred on executive authorities. It is the duty of the court to strike down without any hesitation an arbitrary power conferred on the executive by the legislature."

56. In 1968, a Constitution Bench of 7-Judges in ***Municipal Corporation of Delhi*** *v.* ***Birla Cotton, Spinning and Weaving Mills, Delhi & Another***, AIR 1968 SC 1232 considered the question whether Section 150 of the Delhi Municipal Corporation Act (66 of 1957) is unconstitutional on the ground that it provided for impermissible delegation of the 'essential legislative function'. On an

examination of the abovementioned authorities, apart from others, Chief Justice Wanchoo, speaking for himself and Justice Shelat, held as follows:

> "28. …… The legislature must retain in its own hands the essential legislative functions and what can be delegated is the task of subordinate legislation necessary for implementing the purposes and objects of the Act. Where the legislative policy is enunciated with sufficient clearness or a standard is laid down, the courts should not interfere. :What guidance should be given and to what extent and whether guidance has been given in a particular case at all depends on a consideration of the provisions of the particular Act with which the Court has to deal including its preamble. Further it appears to us that the nature of the body to which delegation is made is also a factor to be taken into consideration in determining whether there is sufficient guidance in the matter of delegation."

The Court held that there was no impermissible delegation of legislative power.

57. Justice Hidayatullah, speaking for himself and for Justice Ramaswami, agreed with the conclusion reached at by the Chief Justice, though on slightly different reasons.

58. In ***M.K. Papiah & Sons*** *v.* ***The Excise Commissioner & Another***, (1975) 1 SCC 492, this Court once again considered the question of delegated legislation in the context of a provision in the Mysore Excise Act which provided for the levy of excise duty "at such rate or rates as the Government may prescribe on excisable goods".

Such a provision was challenged as unconstitutional on the ground that it was a case of abdication of essential legislative function by the legislature. The Court after reviewing the number of earlier decisions held the impugned provision to be valid. Placing reliance on a judgment of the Privy Council in the case of ***Cobb & Co.*** *v.* ***Kropp*** [1967 1 AC 141], this Court held as follows:-

> "23. The point to be emphasized – and this is rather crucial – is the statement of their Lordships that the Legislature preserved its capacity intact and retained perfect control over the Commissioner for Transport inasmuch as it could at any time *repeal the legislation and withdraw the authority and discretion it had vested in him*, and, therefore, the Legislature did not abdicate its functions.

In other words, the very fact that the legislature has the power to repeal and withdraw the authority of the delegate and the discretion vested in the delegate, should lead to the conclusion that the legislature did not abdicate its essential functions.

59. According to Seervai, by its judgment in ***M.K. Papiah's case*** (supra), this Court "after twenty five years of wandering in the legal maze of its own creation" …… "come round to the view expressed by the Privy Council in 1878" i.e. ***Queen*** *v.* ***Burah*** [1878 (5) Ind App 178].

60. This Court in the case of ***Registrar of Cooperative Societies*** *v.* ***K. Kunjaboo***, AIR 1980 SC 350 took note of the uncertainty prevailing in the following words;

> "2. Lawyers and judges have never ceased to be interested in the question of delegated legislation and since the Delhi Laws Act case, we have been blessed by an abundance of authority, the blessing not necessarily unmixed. We do not wish, in this case, to search for the precise principles decided in the **Re Delhi Laws Act** case, nor to consider whether *M.K. Papiah v. Excise Commissioner* beats the final retreat from the earlier position. For the purposes of this case we are content to accept the "policy" and "guidelines" theory and seek such assistance as we may derive from cases where near identical provisions have been considered."

This Court declined "to consider whether ***M.K. Papiah & Sons*** *v.* ***The Excise Commissioner***, (1975) 3 SCR 607, beat the final retreat from the earlier position" but proceeded to examine the case before it on the theory of "policy" and "guidelines" propounded in some of the cases.

61. We can safely state that none of the judgments of this Court so far has laid down any principle indicating as to what exactly constitutes "essential legislative function".

62. While the ***Delhi Laws Act's*** case dealt with the delegation of power to the Executive by the Legislature of applying certain laws with or without modification to new territories, the other cases

essentially dealt with the permissibility of the delegation of the power to the Executive to fix the rates of tax etc.

63. An examination of the above authorities, in our view leads to the following inferences;

(i) The proposition that essential legislative functions cannot be delegated does not appear to be such a clearly settled proposition and requires a further examination which exercise is not undertaken by the counsel appearing in the matter. We leave it open for debate in a more appropriate case on a future date.

For the present, we confine to the examination of the question:

(a) Whether defining every expression used in an enactment is an essential legislative function or not?

(ii) All the judgments examined above recognize that there is a need for some amount of delegated legislation in the modern world.

(iii) If the parent enactment enunciates the legislative policy with sufficient clarity, delegation of the power to make subordinate legislation to carry out the purpose of the parent enactment is permissible.

(iv) Whether the policy of the legislature is sufficiently clear to guide the delegate depends upon the scheme and the provisions of the parent Act.

(v) The nature of the body to whom the power is delegated is also a relevant factor in determining "whether there is sufficient **guidance** in the matter of delegation."

64. Whether defining every word employed in a statute is really necessary and whether it is a part of the essential legislative function was never the subject matter of debate in any of these cases.

65. We are of the firm opinion that it is not necessary that legislature should define every expression it employs in a statute. If such a process is insisted upon, legislative activity and consequentially governance comes to a standstill. It has been the practice of the legislative bodies following the British parliamentary practice to define certain words employed in any given statute for a proper appreciation of or the understanding of the scheme and purport of the Act. But if a statute does not contain the definition of a particular expression employed in it, it becomes the duty of the courts to expound the meaning of the undefined expressions in accordance with the well established rules of statutory interpretation.

66. Therefore, in our opinion, the function of prescribing the norms for classifying a borrower's account as a NPA is not an essential legislative function. The laying down of such norms requires a constant and close monitoring of the financial system demanding considerable amount of expertise in the areas of public finance,

banking etc., and the norms may require a periodic revision. All that activity involves too much of detail and promptitude of action. The crux of the impugned Act is the prescription that a SECURED CREDITOR could take steps contemplated under Section 13(4) on the "default"[23] of the borrower. The expression "default" is clearly defined under the Act. Even if the Act were not to be on the statute book, under the existing law a CREDITOR could initiate legal action for the recovery of the amounts due from the borrower, the moment there is a breach of the terms of the contract under which the loan or advance is granted. The stipulation under the Act of classifying the account of the borrower as NPA as a condition precedent for enforcing the security interest is an additional obligation imposed by the Act on the CREDITOR. In our opinion, the borrower cannot be heard to complain that defining of the conditions subject to which the CREDITOR could classify the account as NPA, is part of the essential legislative function. If the Parliament did not choose to define the expression "NPA" at all, Court would be bound to interpret that expression as long as that expression occurs in Section 13(2). In such

[23] **Section 2(1) (j)** "default" means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor ;

a situation, Courts would have resorted to the principles of interpretation (i) as to how that expression is understood in the commercial world, and (ii) to the existing practice if any of either the particular CREDITOR or CREDITORS as a class generally. If the Parliament chose to define a particular expression by providing that the expression shall have the same meaning as is assigned to such an expression by a body which is an expert in the field covered by the statute and more familiar with the subject matter of the legislation, in our opinion, the same does not amount to any delegation of the legislative powers. Parliament is only stipulating that the expression "NPA" must be understood by all the CREDITORS in the same sense in which such expression is understood by the expert body i.e., the RBI or other REGULATORS which are in turn subject to the supervision of the RBI. Therefore, the submission that the amendment of the definition of the expression 'non-performing asset' under Section 2(1)(o) is bad on account of excessive delegation of essential legislative function, in our view, is untenable and is required to be rejected.

67. Coming to the submission that by authorizing different REGULATORS to prescribe different norms for the identification of a NPA with reference to different CREDITORS amount to unreasonable

classification is also required to be rejected for the reason that all the CREDITORS do not form a uniform/homogenous class.

68. There are innumerable differences among the CREDITORS. Differences based on the legal structure of the CREDITORS' organization, differences based upon the nature of the loan advanced by them, and differences based on the terms and conditions subject to which such loans or advances are made by each of those CREDITORS, etc. For example, the Exim Bank loans are generally in foreign currencies. Similarly, loans granted by Housing Finance CREDITORS which are in turn regulated by the National Housing Bank are loans which are term loans for relatively longer periods than other loans. There is nothing uniform about these CREDITORS or their activities.

69. It is submitted by learned counsel for the RBI -

> "Prior to the amendment in 2004, NPA was defined as sub-standard, doubtful or loss asset in accordance with the directions or under guidelines relating to assets classification issued by the Reserve Bank. Irrespective of whether the financial entity was regulated by RBI or not, for the purposes of SARFAESI Act, the asset classification stipulated by RBI was applicable. Though the regulator concerned of the financial entity had stipulated different standards for regulatory purposes, the entities had to apply the criteria stipulated by RBI for asset classification so far as SARFAESI Act was concerned. The amendment brought about in 2004 addresses this issue and brings in uniformity in the classification of assets by financial entities, both for the purposes of complying with the directions issues by their own

regulations and for the purposes of SARFAESI Act. As such, a situation where an asset is not an NPA as per the specifications of the regulator but the same asset is an NPA for the purposes of SARFAESI Act or vice versa does not arise after the amendment made in 2004."

70. The Union of India filed a counter affidavit (through Director, Department of Financial Services, Ministry of Finance) before the High Court of Gujarat in Special Civil Application No.2910 of 2013 regarding the purpose for which the impugned amendment was brought in. It is stated in the counter affidavit as follows:

"9. I state and submit that the amendment in Section 2(1)(o) of SARFAESI Act, 2002 was made in 2004 to extend the classification norms of non-performing assets stipulated buy (*sic* by) the concerned regulator who is administering or regulating such entity or the Reserve Bank of India when the said institution is not regulated by any regulator in India. There are financial institutions such as Housing Finance corporations notified by Central Government under SARFAESI Act, which are regulated by National Housing Bank. The non-performing assets of these institutions are classified as per guidelines prescribed by National Housing Bank. The Act covers certain other institutions such as Asian Development Bank and assets are classified as per the guidelines prescribed by Reserve Bank of India. The above amendments in the Act were made so that the guidelines issued by concerned regulator as applicable to them are covered for the purpose of recovery under the Act.

10. I further state and submit that the amendment covered the entities under the Act regulated by different regulators such as Reserve Bank of India, National Housing Bank etc. who had stipulated their own guidelines for the purpose. At the same time, the amendment also covered the entities like Asian Development Bank, which did not fall within the purview of any regulator in India. Therefore, the amendment was made in the Act to take care of these situations and these amendments were necessary to cover the deficiencies noticed in the Act."

71. Therefore, to say that enabling them to follow different norms would be violative of Article 14, in our view, would be wholly untenable.

72. Coming to the third submission of the borrower, we would not like to deal with this submission in the instant batch of cases as there are few cases where factually the SECURED ASSETS have been transferred by the ORIGINAL CREDITORS. Those cases have been de-tagged from this batch to be heard separately.

73. Coming to the fourth submission of the borrower, it must fail on the basis of express language of Section 13(3A)[24] which obligates the SECURED CREDITORS to examine the representation/objection, if any, made by the borrower on the receipt of notice contemplated under Section 13(2) and communicate the reasons to the borrower if such a representation is not accepted by the SECURED CREDITORS. We have already indicated in our judgment, in para no. 48, that the representation/objection contemplated under Section 13(3A) is

[24] Section 13(3A). If, on receipt of the notice under sub-section (2), the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within fifteen days of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower.

Provided that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A.

required to be examined objectively. Section 13 obligates the SECURED CREDITOR to communicate the reasons for non-acceptance of the representation or objections to the borrowers.

74. Before closing these matters, we may also deal with one aspect of the judgment of the Gujarat High Court. The Gujarat High Court recorded that the impugned amendment is *ultra vires* the object of the Act. We presume for the sake of this judgment that the impugned amendment is not strictly in consonance with the objects enunciated when the Act was initially made. We fail to understand as to how such inconsistency will render the Act unconstitutional. The objects and reasons are not voted upon by the legislature. If the enactment is otherwise within the constitutionally permissible limits, the fact that there is a divergence between the objects appended to the Bill and the tenor of the Act, in our opinion, cannot be a ground for declaring the law unconstitutional.

75. In view of our abovementioned conclusions, we do not propose to examine other submissions regarding the correctness of the Gujarat High Court's declaration that the unamended definition of the expression "NPA" would continue to govern the situation in view of

the Gujarat High Court's conclusion that the amended definition of NPA is unconstitutional.

76. All the writ petitions and the appeals are disposed of declaring that the amended definition of the expression "NPA" under Section 2(1)(o) of the Act is constitutionally valid.

77. In the result, all the writ petitions either filed before this Court or filed before the Madras and Gujarat High Courts and the appeals of the borrowers stand dismissed. The appeals of the CREDITORS are allowed. Each of the writ petitioners/borrowers shall pay costs to the respective CREDITORS calculated at 1% of the amount outstanding on the date of the notice under Section 13(2) of the Act in each of the cases.

.....J.
(J. CHELAMESWAR)

.....J.
(S.A. BOBDE)

New Delhi;
January 28, 2015