

LAW & POLICY UPDATE

RESTRUCTURING & INSOLVENCY



The loan moratorium judgment: Key takeaways

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The Supreme Court (SC) vide Judgment dated March 23, 2021, in the matter of *Small-Scale Industrial Manufactures Association (Regd.) v. Union of India & Ors*¹ (The Loan Moratorium Case), offered a solution to all the stakeholders in the ongoing scuffle between the Lenders and the Borrowers pertaining to charging of interest on loans during the moratorium period provided by the Reserve Bank of India (RBI) on payment of installments. The Court decided to not interfere with the economic prudence of the Central Government and the RBI on the loan moratorium policy and ruled against the reliefs sought by the Petitioners to extend the monthly loan moratorium offered by the RBI. However, in the interest of justice and to provide relief to the borrowers, the SC also decided that there shall not be any charge of interest on interest/compound interest/penal interest on interest for the period during moratorium.

Background Facts

- The RBI on March 27, 2020 issued the Statement of Development and Regulatory Policies (RBI Circular) where *inter alia* certain regulatory measures were announced to mitigate the burden of debt servicing brought about by disruptions on account of Covid-19 pandemic and to ensure the continuity of viable businesses.
- The Notification dated March 27, 2020, issued by the RBI was primarily for rescheduling payments – Term Loans and Working Capital Facilities. As per the RBI notification, all the commercial banks, cooperative banks, all India Financial Institutions, and NBFCs were permitted to grant a moratorium of three months on payment of all instalments falling due between March 1, 2020 and May 31, 2020 and the repayment schedule for such loans as also the residual tenor will be shifted across the board by three months after the moratorium period. Thereafter, due to the extension of the nationwide lockdown, the RBI, by a subsequent notification dated May 23, 2020 directed all commercial banks to extend the moratorium by another three months, i.e., from June 01, 2020 to August 31, 2020.
- The relief in the notifications dated March 27, 2020 and May 23, 2020 by the RBI was followed by a condition that interest shall continue to accrue on the outstanding portion of the term loans during the moratorium period.
- Aggrieved by this condition of accrual of interest on outstanding loan payments during the moratorium period, various MSME associations, real estate sector associations along with various other borrowing parties approached the Apex Court via several Writ Petitions seeking complete waiver of the accrued compound interest/interest during the moratorium period along with extension of the moratorium period beyond August 31, 2020.
- To this effect, the counsel for the Petitioners advanced their arguments on the deficiency on the part of the Central Government to recognize the severity and magnitude of the pandemic and the financial distress caused not only to each and every individual but also to various industrial sectors of the economy.

Our viewpoint

In our opinion, this judgment has brought a sigh of relief to the banks by saving a total loss of almost 6 Lakh Crores that would have been caused in case the total waiver on interest would have been allowed. Further, a balanced decision has been taken by the Court while maintaining the integrity of the Principle of Separation of Powers. This decision has granted relief regarding the interest-on-interest structure and saved the additional burden which would have been caused to the borrowers. However, in this backdrop with the government agreeing to bear the burden of compound interest waiver, the ultimate burden of this exercise will fall on the average taxpayer. This, compounded with the pressure on the borrowers and the precarious position of the economy, is likely to throw up a number of challenges which will have to be overcome collectively.

¹ Writ Petition (C) No. 476 OF 2020

- To support their arguments pertaining to the cause and effect of the RBI Circular, the Petitioners argued that the aspects of 'disaster management', which inter alia include grant of relief and concessions to the distressed community of borrowers affected by the disaster, had not been considered. Reliance was placed on Section 72² of the Disaster Management Act, 2005 (DMA) to state that the provision of the DMA has an overriding effect over other laws and authorities. Thus, Section 133 of the DMA casts duty upon the National Authority to recommend relief in the matter of repayment of loans and/or grant of fresh loans on 'concessional terms' to the persons affected by the disaster.
- In view of the above, it was concluded by the Petitioners that the RBI was not the statutory authority, though it may have a supportive role to play to take a decision in regard to the measures of relief and concession to the disaster affected persons arising out of the task management under the DMA, 2005.
- Per Contra, the Counsels for the Respondents, particularly the Central Government and the RBI, argued upon the extent of the word 'Moratorium' with regard to definition by the RBI in the RBI Circular and stated that the word moratorium was never intended to be 'waiver of interest' but 'deferment of interest', therefore, the payment of interest and interest on interest was merely deferred and was never waived.
- It was also brought to the notice of the Court by the Counsel of the Central Government that in order to provide further relief from the financial distress and the burden of being declared insolvent, the Central Government via Insolvency and Bankruptcy Code (Ordinance) 2020 dated June 05, 2020 had provided protection to the Corporate Borrowers by suspending the operations of the Section 7, Section 9 and Section 10 of the Insolvency and Bankruptcy Code, 2016.
- Further, contending the arguments made by the Petitioners pertaining to the overriding effect of DMA, 2005 as per Section 72 and thereafter the application of Section 13 of the DMA, 2005, the Respondents relied upon the decision of the SC in the matter of *Pradip Kumar Maity v. Chinmoy Kumar Bhunia*⁴, and *Union of India v. Kumho Petrochemicals Co Ltd*⁵, and contended that the word 'may' used in Section 13 of the DMA, 2005 is to be read as an enabling discretionary provision and not mandatory. Therefore, the same is to be considered as a 'recommendation' and not as an 'obligation'.

Reliefs sought

- Waiver of compound interest/interest on interest and total interest during the moratorium period
- Extension of moratorium period beyond August 31, 2020
- Further reliefs to support and reduce the financial burden endowed upon the effected parties in the backdrop of Covid-19

Findings of the court

- Pursuant to the arguments made by the parties, SC reserved itself from adjudicating upon matters concerning commercial wisdom and intricacies of trade and commerce as it has a limited scope of judicial review in economic policy matters. The Court further reiterated the decision laid down in the matter of *State of M.P. v. Nandala Jaiswal*⁶ and *BALCO Employees' Union (Regd.) v. Union of India*⁷, whereafter it was observed that wisdom and advisability of economic policies are not amenable to judicial review unless it can be demonstrated that the policy is contrary to any statutory provision or the Constitution. What is best in the national interest what manner and to what extent the financial reliefs/packages be formulated, offered and implemented is ultimately to be decided by the Government and the RBI on the aid and advice of the experts. The same is a matter for decision exclusively within the province of the Central Government and such matter do not attract the power of judicial review. In view of this, the SC refused to grant relief sought by the petitioners to issue any Writ of Mandamus directing the Central Government and RBI to declare/announce further relief packages.
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² Section 72 - **Act to have overriding effect.**- The provisions of this Act, shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.

³ Section 13 Relief in loan repayment, etc. - The National Authority may, in cases of disasters of severe magnitude, recommend relief in repayment of loans or for grant of fresh loans to the persons affected by disaster on such concessional terms as may be appropriate.

⁴ (2013) 11 SCC 122 (para 6)

⁵ (2017) 8 SCC 307 (paras 34 &35)

⁶ (1986) 4 SCC 566

⁷ (2002) 2 SCC 333

- The Court further reiterated the decision laid down in the matter of *State of M.P. vs. Nandala Jaiswal*⁸ and *BALCO Employees' Union (Regd.) v. Union of India*⁹, whereafter it was observed that wisdom and advisability of economic policies are not amenable to judicial review unless it can be demonstrated that the policy is contrary to any statutory provision or the Constitution. What is best in the national interest what manner and to what extent the financial reliefs/packages be formulated, offered and implemented is ultimately to be decided by the Government and the RBI on the aid and advice of the experts. The same is a matter for decision exclusively within the province of the Central Government and such matter do not attract the power of judicial review. In view of this, the SC refused to grant relief sought by the petitioners to issue any Writ of Mandamus directing the Central Government and RBI to declare/announce further relief packages.
- The Court also briefly shed light upon the overriding effect and statutory obligations on the National Authority as per Section 72 and Section 13 respectively of the DMA, 2005 and was in agreement with the arguments advanced by the Respondents, that the word 'may' used in Section 13 of the DMA, 2005 is to be read as an enabling discretionary provision and not mandatory.
- Further, with regard to the relief sought on complete waiver of the interest charged on the loan during the moratorium period, the Court premised its decision around the working of the banking system with regard to the payment of interest by the Bank to all its depositors irrespective of the amount deposited and stated that even during the moratorium period as per the RBI Circular, the liability of the Banks and the Lenders to pay interest to its depositors continued. Therefore, to grant a complete waiver of interest on the loan instalments during the moratorium period would have a far-fetching financial implication in the economy of the country as well as on the banks and other lenders. Therefore, no such total waiver of interest can be granted as the same would cause prejudice to the entire economy.
- However, while concluding its observations, the Court, in the interest of justice to all concerned parties, inclined itself towards the fact that once the payment of instalment is deferred as per the circular dated March 27, 2020, the non-payment of instalment during the moratorium period cannot be said to be wilful and, therefore, it is not justified to penalise the borrowers by charging interest on the interest/compound interest accrued for the period during moratorium.

Decision of the Court

- In view of the above observations, SC refused to adjudicate upon the economic decision taken by the Central Government and the RBI and also refused to extend the moratorium beyond August 31, 2020 as provided under the RBI Circular. With regard to the effect that will be caused on the economy of the country, the Supreme also refused to grant total waiver of the interest on the Loan Payments which was accrued during the moratorium period. Lastly, the Court directed the Banks to not charge any interest on interest/compound interest/penal interest for the period during the moratorium and any amount already recovered under the same head (i.e. interest on interest/compound interest/penal interest) shall be refunded to the concerned borrowers and to be given credit or adjusted in the next instalment of the loan account.

⁸ (1986) 4 SCC 566

⁹ (2002) 2 SCC 333

