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DEBT RECOVERY

SARFAESI Act Prevails Over MSMED Act: Supreme Court

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The Supreme Court's Division Bench comprising of Justice M.R. Shah and Justice Krishna Murari in [Kotak Mahindra Bank Limited vs Girnar Corrugators Pvt. Ltd¹](#), vide judgment dated 05.01.2023, held that Micro, Small and Medium Enterprises Development Act, 2006 ([MSMED Act](#)) will not prevail over Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ([SARFAESI Act](#)).

Facts:

The Appellant Bank being a secured creditor of borrower M/s. Mission Vivacare (**Borrower**), had initiated recovery proceedings under Section 13(2) of the SARFAESI Act and thereafter filed an application before the District Magistrate under Section 14 of the SARFAESI Act for taking physical possession of the secured assets which was allowed with directions to the Sub-Divisional Magistrate (**SDM**), District: Dhar to handover vacant possession of the secured assets to the Appellant Bank. However, since no action was taken, the Appellant Bank filed an Application complaining non-compliance of the said order to take physical possession. Accordingly, the SDM thereafter directed the Naib Tehsildar to comply with the order of the District Magistrate and obtain physical possession by taking police assistance, if required. The Naib Tehsildar however refused to take possession on the ground that a recovery certificate had already been issued in favor of another creditor of the Borrower, under the [MSMED Act](#), and observed that since the MSMED Act was a special enactment that came into effect subsequent to the SARFAESI Act, the MSMED Act would have overriding effect and would therefore prevail over the SARFAESI Act.

The above decision of the Naib Tehsildar was challenged in writ before the Single Judge of the [Madhya Pradesh High Court](#) at Indore. The Single Judge reversed the order of the Naib Tehsildar to hold that the provisions of the SARFAESI Act would prevail, and if the other Borrower were aggrieved by the order of the District Magistrate, they may approach the Debts Recovery Tribunal (**DRT**) under Section 17 of the SARFAESI Act.

The judgment of the Single Judge was challenged by an Appeal before the Division Bench of the Madhya Pradesh High Court. The Division Bench allowed the said appeal and set aside the judgment of the Single Judge Bench, by observing that the MSMED Act being the later enactment would prevail over SARFAESI Act.

The aforesaid judgment of the Division Bench (**Impugned Judgment**) has been challenged by the Appellant Bank by way of the present Appeal before the Supreme Court.

Contentions of the Parties:

The Appellant argued that there is no inconsistency between the MSMED Act and SARFAESI Act since Section 24 of the MSMED Act only confers a notwithstanding effect to Sections 15 to 23 of the MSMED Act, which provides for a special mechanism for adjudication of the dispute along with enforcing certain other contractual and business terms on the parties such as time limit for payments and interest in case of delayed payments. The Appellant contended that the MSMED Act does not provide for express priority for payments over and above that which is due to secured creditors and/or the government, unlike the SARFAESI Act. The Appellant also contended that the notwithstanding clause under SARFAESI Act i.e., Section 26E was subsequently inserted vide an amendment in 2016 and will therefore prevail over the provisions of the MSMED Act.

The Respondent No.1 i.e. the other borrower, argued that MSMED Act had been enacted to promote and protect the interests of the small and medium scale enterprises and was a beneficial legislation which had included aggressive provisions to protect the livelihood of several citizens who contribute towards 27% of the GDP. The Respondent No.1 contended that banks have various other means of recovery such as the Insolvency and Bankruptcy Code, 2016 or taking personal guarantees, which are not available to MSMEs. The Respondent No.1 also argued that if the SARFAESI Act were given precedence, the awards of the Facilitation Council under the MSMED Act would be rendered non-executable in all scenarios where there is a secured creditor. The Respondent No.1 argued that on giving a purposive interpretation, the MSMED Act ought to prevail over the SARFESI Act.

Findings of the Supreme Court:

The Supreme Court agreed with the Appellant and held that there was no conflict between the schemes of the SARFAESI Act and the MSMED Act.

The Supreme Court observed that in the absence of any specific priority under the MSMED Act, the provisions of the SARFAESI Act, which were subsequently amended in 2016, would prevail. The Supreme Court held as follows:

“7... In the entire MSMED Act, there is no specific express provision giving ‘priority’ for payments under the MSMED Act over the dues of the secured creditors or over any taxes or cesses payable to Central Government or State Government or Local

Authority as the case may be. In sharp contrast to this, Section 26E of the SARFAESI Act which has been inserted vide Amendment in 2016, it provides that notwithstanding anything inconsistent therewith contained in any other law for the time being in force, after the registration of security interest, the debts due to any secured creditor shall be paid in 'priority' over all other debts and all revenue taxes and cesses and other rates payable to the Central Government or State Government or Local Authority.

... Even as per the submission on behalf of respondent No.1, two enactments have competing non-obstante provision and nothing repugnant, then the non-obstante clause of the subsequent statute would prevail over the earlier enactments. As per the settled position of law, if the legislature confers the later enactment with a non-obstante clause, it means the legislature wanted the subsequent / later enactment to prevail. Thus, a 'priority' conferred / provided under Section 26 E of the SARFAESI Act would prevail over the recovery mechanism of the MSMED Act.”

The Supreme Court also observed that the order passed by the Naib Tehsildar was without jurisdiction since neither the Naib Tehsildar nor the District Magistrate has the power to even adjudicate the dispute between a secured creditor and the debtor under Section 14 of the SARFAESI Act, and that the recourse available to any party aggrieved by the steps taken under Section 14 is to approach the DRT by way of a Securitization Application under Section 17 of the SARFAESI Act.

The Supreme Court proceeded to set-aside the Impugned Judgment of the Division Bench, restored the judgement of the Single Judge, and accordingly allowed the present appeal.

1 Civil Appeal No. 6662 of 2022