

M/s Pro Knits

v.

The Board of Directors of Canara Bank & Ors.

(Civil Appeal No. 8332 of 2024)

01 August 2024

[Bela M. Trivedi* and R. Mahadevan, JJ.]

Issue for Consideration

Whether the Notification dated 29.05.2015 issued by the Central Government in exercise of the powers conferred under Section 9 of the Micro, Small and Medium Enterprises Development Act, 2006, containing Instructions for the “Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises” as revised from time to time, is mandatory or directory.

Headnotes[†]

Micro, Small and Medium Enterprises Development Act, 2006 – ss.9, 10 – The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 – Banking Regulation Act, 1949 – ss.21, 35A – Loan accounts of the appellants-MSMEs were classified as Non-Performing Assets (NPA) by the respondents-Banks/Non-Banking Financial Companies (NBFCs) without following the procedure laid down in the Instructions for Framework for Revival and Rehabilitation of MSMEs issued vide Notification dated 29.05.2015 to provide a simpler and faster mechanism to address the stress in the accounts of MSMEs and to facilitate the promotion and development of MSMEs – Challenged by appellants – Writ petitions dismissed by High Court holding that the Banks/ NBFCs were not obliged to adopt the restructuring process contemplated in the aforesaid Notification on its own without there being any application by the MSMEs – Correctness:

Held: Not correct – Instructions for the “Framework for Revival and Rehabilitation of MSMEs” as notified vide Notification dated 29.05.2015 in exercise of the powers conferred u/s.9 of the MSMED Act, as revised by the RBI Notification dated 17.03.2016 and the Reserve Bank of India (Lending to Micro, Small and Medium Enterprises Sector) Directions, 2016, issued by RBI in exercise of the powers conferred by ss.21 and 35(A) of the Banking Regulation

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

Act, having statutory force, are mandatory in nature and binding on all Scheduled Commercial Banks, licensed to operate in India by RBI – Under the “Framework for Revival and Rehabilitation of MSMEs”, the banks or creditors are required to identify the incipient stress in the account of the MSMEs, before their accounts turn into non-performing assets, by creating three sub-categories under the “Special Mention Account” Category – Further, it is also incumbent on the part of the concerned MSME to produce authenticated and verifiable documents/material for substantiating its claim of being MSME, before its account is classified as NPA – If that is not done, and once the account is classified as NPA, the banks-secured creditors would be entitled to take the recourse to Chapter III of the SARFAESI Act for the enforcement of the security interest – Impugned order set aside. [Paras 13, 16, 19]

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 – Chapter III; ss.35, 13 – Enforcement of security interest created in favour of secured creditor – Process of initiation:

Held: Security interest created in favour of any Bank or secured creditor may be enforced by such creditor in accordance with the provisions contained in Chapter-III of the SARFAESI Act – As per s.35, the provisions of the SARFAESI Act have the effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law – However, the process of enforcement of security interest as contained in Chapter III could be initiated only when the borrower 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, in view of Section 13(2) of the said Act. [Para 14]

Banking Regulation Act, 1949 – ss.21, 35A – Directions issued under, mandatory:

Held: ss.21 and 35A empower the RBI to frame the policy and give directions to the banking companies in relation to the advances to be followed – Such directions supplement the provisions of the Banking Regulation Act and have statutory force and are mandatory. [Para 13]

Micro, Small and Medium Enterprises Development Act, 2006 – Securitisation and Reconstruction of Financial Assets

Digital Supreme Court Reports

and Enforcement of Security Interest Act, 2002 – MSMEs obligated to substantiate their claim of being MSME and to show their eligibility to get the benefit of the Framework for Revival and Rehabilitation of MSMEs issued vide Notification dtd. 29.05.2015:

Held: It is mandatory or obligatory on the part of the Banks to follow the Instructions/Directions issued by the Central Government and the RBI with regard to the Framework for Revival and Rehabilitation of MSMEs – Thus, it is equally incumbent on the part of the concerned MSMEs to be vigilant enough to follow the process laid down under the said Framework, and bring to the notice of the concerned Banks, by producing authenticated and verifiable documents/material to show its eligibility to get the benefit of the said Framework. [Para 17]

List of Acts

Micro, Small and Medium Enterprises Development Act, 2006; The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; Banking Regulation Act, 1949.

List of Keywords

Micro, Small and Medium Enterprises; MSMEs; Framework for Revival, Rehabilitation of MSMEs; Promotion and development of MSMEs; Instructions/Directions/Guidelines issued by RBI; Guidelines/instructions pertaining to MSMEs; Loan accounts; Non-Performing Assets (NPA); Banks and Non-Banking Financial Companies (NBFCs); Restructuring process; Mandatory instructions; Mandatory; Directory; Incipient stress; Secured creditors; Security interest; Enforcement of security interest; Reserve Bank of India (RBI); Defaulters-Borrowers; RBI Notification; Banking companies.

Case Arising From

CIVIL APPELLATE JURISDICTION: Civil Appeal No.8332 of 2024

From the Judgment and Order dated 11.01.2024 of the High Court of Judicature at Bombay in WPL No.20100 of 2023

With

Civil Appeal Nos. 8333, 8334, 8335, 8336 and 8337 of 2024

M/s Pro Knits v. The Board of Directors of Canara Bank & Ors.**Appearances for Parties**

Nikhil Goel, Sr. Adv., Nachiketa Vajpayee, Ms. Divyangna Malik, Sriram P., Mathews J. Nedumpara, Ms. Usha Nandini V., Ms. Maria Nedumpara, Ms. Hemali Kurne, Ms. Rohini Amin, Shameem Fayiz, Advs. for the Appellant.

Dinkar Singh, Deepak Goel, Ms. Alka Goyal, Ms. Rubi Kumari, Ms. Harshita Maheshwari, Rajesh Kumar Gautam, Anant Gautam, Dinesh Sharma, Ms. Shivani Sagar, R.P. Daida, Ms. Kavitoli G Yetho, Kushagra Nilesh Sahay, Ajay Choudhary, Tikshta Modi, Sonia Munjal, Anshuman Gupta, Prashant Alai, Kunal Mimani, Advs. for the Respondents.

Judgment / Order of the Supreme Court**Judgment**

Bela M. Trivedi, J.

1. Leave granted.
2. The Appellants in this batch of Appeals, who claim themselves to be the Micro, Small and Medium Enterprises (MSMEs) registered under the Micro, Small and Medium Enterprises Development Act, 2006 (hereinafter referred to as the “MSMED Act”), have challenged the impugned common order dated 11.01.2024 passed by the High Court of Judicature at Bombay in Writ Petition (L) No. 20100 of 2023 and Others, whereby the High Court has dismissed the said Writ Petitions by holding that the Banks/ Non-Banking Financial Companies (NBFCs) are not obliged to adopt the restructuring process as contemplated in the Notification dated 29th May, 2015 issued by the Ministry of Micro, Small and Medium Enterprises, on its own without there being any application by the Petitioners/ MSMEs. The High Court without expressing any opinion on the merits or the factual aspects of the writ petitions granted leave to the Appellants -Writ Petitioners to agitate the other issues by adopting alternative remedies as may be available to them under the law.
3. The learned Counsels for the parties in the instant Appeals have also restricted their submissions only to the said issue decided by the High Court, without addressing other issues on the facts and merits involved in the writ petitions.

Digital Supreme Court Reports

4. The Appellants who were the Writ Petitioners before the High Court had basically challenged the actions of the Respondents Banks/ NBFCs taken by them against the appellants under the provisions contained in The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (hereinafter referred to as the “SARFAESI Act”). The bone of contention raised by the learned Counsel Mr. Mathews Nedumpara appearing for the Appellants in all the Appeals is that the respondents-Banks could not have classified the loan accounts of the appellants who were the MSMEs, as Non-Performing Assets (NPA), without following the procedure laid down in the Instructions for Framework for Revival and Rehabilitation of MSMEs issued vide the Notification dated 29th May, 2015 by the Ministry of MSME, in exercise of the powers conferred under Section 9 of the MSMED Act. According to him, it was incumbent on the part of the Respondents Banks/ NBFCs to identify incipient stress in the account by creating three sub categories as mentioned in the said Notification and to explore various options to resolve the stress in the account as contemplated in the said Notification. He further submitted that the said Notification and the subsequent Instructions/Directions issued by the Central Government and the Reserve Bank of India are for the purpose of facilitating the promotion and development and enhancing the competitiveness of MSMEs and therefore it was mandatory on the part of the respondents to follow the same. Non-observance of the mandatory Instructions contained in the said Notification has rendered all the subsequent actions taken by the respondents under the SARFAESI Act, illegal and *void ab initio*.
5. However, the learned Counsels appearing for the Respondents Banks/ NBFCs contended that the High Court has rightly not considered the process or procedure laid down in the Notification dated 29.05.2015 as mandatory, in as much as the provisions contained in the SARFAESI Act override the provisions of the other Acts including the MSME Act as per Section 35 of the said Act. In the instant cases, the concerned appellants had not applied to the Respondents Banks to avail the benefit of the said Notification at the relevant time and the Respondents Banks have already initiated and in certain cases concluded the proceedings undertaken under the SARFAESI Act after following the due process of law. They further submitted that the process of restructuring as contemplated in the

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

said Notification and classification of borrower's account as NPA are two independent subjects and therefore it can not be interpreted that unless the procedure under the said Notification for restructuring is adopted, the appellants accounts could not have been classified as NPAs. According to them, the Instructions issued under Section 9 of the MSMED Act are mere directory and not mandatory nor do they have any statutory force.

6. Before delving into the issue involved in the instant appeals as to whether the Notification dated 29.05.2015 issued by the Central Government in exercise of the powers conferred under Section 9 of the MSMED Act, as revised from time to time, is mandatory or directory, let us have a glance over the relevant provisions of the MSMED Act. It may be noted that the very object and purpose of the MSMED Act is to provide for facilitating the promotion and development and enhancing the competitiveness of Micro, Small and Medium Enterprises and for matters connected therewith and incidental thereto. Section 9 thereof empowers the Central Government to take measures for the purpose of facilitating such promotion and development and enhancing competitiveness of MSMEs by specifying the programmes, guidelines or instructions as it may deem fit, by issuing Notifications.
7. Section 10 of the MSMED Act states that the policies and practices in respect of the credit to the Micro, Small and Medium Enterprises shall be progressive and such as may be specified in the guidelines or instructions issued by the Reserve Bank, from time to time, to ensure timely and smooth flow of credit to such enterprises, minimize the incidence of sickness among and enhance the competitiveness of such enterprises.
8. At this juncture, it would also be apt to refer to the relevant provisions contained in the Banking Regulation Act, 1949. Section 21 of the said Act empowers the Reserve Bank of India to control advances by Banking companies. The said section *inter alia* provides that where the Reserve Bank is satisfied that it is necessary or expedient in the public interest or in the interest of the depositors or banking policy so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any company in particular and when the policy has been so determined, all banking companies or the banking company concerned, as the case may be,

Digital Supreme Court Reports

shall be bound to follow the policy as so determined. Sub-section (3) of Section 21 states that every banking company shall be bound to comply with any directions given to it under the said Section. Further, Section 35A of the said Banking Regulation Act reads as under: -

“35A. Power of the Reserve Bank to give directions. —

- (1) Where the Reserve Bank is satisfied that-
 - (a) in the public interest; or
 - (aa) in the interest of banking policy; or
 - (b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or
 - (c) to secure the proper management of any banking company generally,

it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

- (2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect.”
9. Thus, Section 21 read with Section 35A makes it clear that the directions issued by the Reserve Bank of India to the Banking companies are binding on them and they are bound to comply with such directions.
10. As stated earlier, the whole controversy in the instant appeals centers around the Notification dated 29.05.2015 issued by the Central Government in exercise of the powers conferred by Section 9 of the MSMED Act. The said Notification contains the Instructions for the “Framework for Revival and Rehabilitation of MSMEs”. The

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

relevant part thereof with regard to the identification of the incipient stress and the committees for stressed MSMEs being relevant are reproduced hereunder: -

“NOTIFICATION”

S.O.(E). 1432 In exercise of the powers conferred in section 9 of the Micro, Small and Medium Enterprises Development Act, 2006, the Central Government, for the purpose of facilitating the promotion and development of Micro, Small and Medium Enterprises, hereby notifies the instructions for the Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises (hereinafter referred to as the “Framework”), which shall come into force on the date of its publication in the official Gazette, namely the **Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises.**

1. Identification of incipient stress

- (1) Identification by Banks or creditors - Before a loan account of a Micro, Small and Medium Enterprise turns into a Non-Performing Asset (NPA), banks or creditors are required to identify incipient stress in the account by creating three sub - categories under the Special Mention Account (SMA) category as given in the Table below:

Special Mention Account Sub-categories	Basis for classification
(1)	(2)
SMA-0	Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress
SMA-1	Principal or interest payment overdue between 31-60 days
SMA-2	Principal or interest payment overdue between 61-90 days

Digital Supreme Court Reports

- (2) Identification by the Enterprise - Any Micro, Small or Medium Enterprise may voluntarily initiate proceedings under this Framework if enterprise reasonably apprehends failure or its business or its inability or likely inability to pay debts and before the accumulated losses of the enterprise equals to half or more of its entire net worth.
- (3) The application for initiation of the proceedings under this Framework shall be verified by an affidavit of authorised person.
- (4) When such a request is received by lender, the account should be processed as SMA-0 and the Committee under this Framework should be formed immediately.

2. Committees for Stressed Micro, Small and Medium Enterprises.

- (1) Subject to any regulations prescribed by the Reserve Bank of India for this Framework, all banks shall constitute one or more Committees at such locations as may be considered necessary by the board of directors of such bank to provide reasonable access, to all eligible Micro, Small and Medium enterprises which have availed of credit facilities from such bank.
- (2) Subject to inclusion in categories referred to in paragraph 1, stressed Micro, Small and Medium Enterprises shall have access to the Committee for stressed Micro, Small and Medium Enterprises for deciding on a corrective action plan and determining the terms thereof in accordance with regulations prescribed in this Framework

Provided that where the Committee decides that recovery is to be made as part of the corrective action plan, the manner and method of recovery shall be in accordance with the existing policies approved by the board of directors of the bank which has extended credit facilities to the

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

enterprise, subject to any regulations prescribed by the Reserve Bank of India.

3-16"

11. The RBI in order to make the said Framework contained in the Notification dated 29.05.2015 compatible with the existing regulatory guidelines on "Income Recognition, Asset Classification and provisioning pertaining to Advances" issued to the banks by the RBI, had made certain changes in the said Framework, in consultation with the Central Government and issued revised Framework along with the operating Instructions vide the Communication dated 17th March, 2016, addressed to all the Scheduled Commercial Banks.
12. It is pertinent to note that in exercise of the powers conferred by Section 21 and 35A of the Banking Regulation Act, 1949, the Reserve Bank of India, after having being satisfied that it was necessary and expedient in the public interest to do so, had issued the Master Direction, called the "Reserve Bank of India [Lending to Micro, Small and Medium Enterprises (MSME) Sector] Directions, 2016," vide the Notification dated 21st July, 2016. The said Directions have been made applicable to every Scheduled Commercial Bank excluding Regional Rural Banks (RRBs) licensed to operate in India by the Reserve Bank of India. Amongst the other Directions, the Direction 4 contained in Chapter IV thereof, pertained to the common guidelines/instructions for lending to MSME Sector. While advising all the Scheduled Commercial Banks to follow the guidelines/instructions pertaining to MSMEs, it was directed in the Direction 4.8 as under: -

"4.8 Framework for Revival and Rehabilitation of MSMEs.

The Ministry of Micro, Small and Medium Enterprises, Government of India, vide their Gazette Notification dated May 29, 2015 had notified a 'Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises' to provide a simpler and faster mechanism to address the stress in the accounts of MSMEs and to facilitate the promotion and development of MSMEs. The Reserve Bank was advised to issue necessary instructions to banks for effective implementation and monitoring of the said Framework. After carrying out certain changes in the captioned Framework in consultation with the Government

Digital Supreme Court Reports

of India, Ministry of MSME so as to make it compatible with the existing regulatory guidelines on 'Income Recognition, Asset Classification and provisioning pertaining to Advances' issued to banks by RBI, the guidelines on the captioned Framework along with operating instructions were issued to banks on March 17, 2016. The revival and rehabilitation of MSME units having loan limits up to Rs.25 crore would be undertaken under this Framework. Banks were required to put in place their own Board approved policy to operationalize the Framework not later than June 30, 2016. The revised Framework supersedes our earlier Guidelines on Rehabilitation of Sick Micro and Small Enterprises issued vide our circular RPCD. CO. MSME & NFS.BC.40/06.02.31/2012-2013 dated November 1, 2012, except those relating to Reliefs and Concessions for Rehabilitation of Potentially Viable Units and One Time Settlement, mentioned in the said circular.

The salient features of the Framework are as under:

- i) Before a loan account of an MSME turns into a Non-Performing Asset (NPA), banks or creditors should identify incipient stress in the account by creating three sub-categories under the Special Mention Account (SMA) category as given in the Framework.
 - ii) Any MSME borrower may also voluntarily initiate proceedings under this Framework.
 - iii) Committee approach to be adopted for deciding corrective action plan.
 - iv) Time lines have been fixed for taking various decisions under the Framework."
13. In view of the above, it is absolutely clear that the Instructions for the Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises as notified by the Central Government vide the Notification dated 29th May, 2015 in exercise of the powers conferred under Section 9 of the MSMED Act, as revised by the RBI Notification dated 17th March, 2016, and the Master Directions i.e. the Reserve Bank of India (Lending to Micro, Small and Medium Enterprises Sector) Directions, 2016, issued by the Reserve Bank of

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

India in exercise of the powers conferred by Section 21 and 35(A) of the Banking Regulation Act, having statutory force, are binding to all Scheduled Commercial Banks, licensed to operate in India by the Reserve Bank of India, as stated in the said Directions. It cannot be gainsaid that the Banking Regulation Act 1949 basically seeks to regulate banking business and mandates a statutory comprehensive and formal structure of banking regulation and supervision in India. Section 21 and Section 35A of the said Act empower the Reserve Bank of India to frame the policy and give directions to the banking companies in relation to the advances to be followed by the banking companies. Such directions have got to be read as supplement to the provisions of the Banking Regulation Act and accordingly are required to be construed as having statutory force and mandatory.

14. As transpiring from the said Instructions/Directions, the entire exercise as contained in the “Framework for Revival and Rehabilitation of MSMEs” is required to be carried out by the banking companies before the accounts of MSMEs turn into Non-Performing Asset. It is true that the security interest created in favour of any Bank or secured creditor may be enforced by such creditor in accordance with the provisions contained in Chapter-III of the SARFAESI Act, and that as per Section 35 of the SARFAESI Act, the provisions of the said Act have the effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law. However, pertinently the whole process of enforcement of security interest as contained in Chapter III of the SARFAESI Act, could be initiated only when the borrower 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, in view of Section 13(2) of the said Act.
15. What is contemplated in the “Framework for Revival and Rehabilitation of MSMEs” contained in the Instructions/ Directions stated hereinabove, is required to be followed prior to the classification of the borrower’s account, (in the instant case MSMEs loan account), as Non-Performing Assets. The said Instructions contained in the Notification dated 29.05.2015 as part of measures taken for facilitating the promotion and development of MSMEs issued by the Central Government in exercise of powers conferred under Section 9 of the MSMED Act, followed by the Directions issued by the RBI in exercise

Digital Supreme Court Reports

of the powers conferred under Section 21 and 35A of the Banking Regulation Act, the Banking companies though may be ‘secured creditors’ as per the definition contained in Section 2 (zd) of the SARFAESI Act, are bound to follow the same, before classifying the loan account of MSME as NPA.

16. We may hasten to add that under the “Framework for Revival and Rehabilitation of MSMEs”, the banks or creditors are required to identify the incipient stress in the account of the Micro, Small and Medium Enterprises, before their accounts turn into non-performing assets, by creating three sub-categories under the “Special Mention Account” Category, however, while creating such sub-categories, the Banks must have some authenticated and verifiable material with them as produced by the concerned MSME to show that loan account is of a Micro, Small and Medium Enterprise, classified and registered as such under the MSMED Act. The said Framework also enables the Micro, Small or Medium Enterprise to voluntarily initiate the proceedings under the said Framework, by filing an application along with the affidavit of an authorized person. Therefore, the stage of identification of incipient stress in the loan account of MSMEs and categorization under the Special Mention Account category, before the loan account of MSME turns into NPA is a very crucial stage, and therefore it would be incumbent on the part of the concerned MSME also to produce authenticated and verifiable documents/material for substantiating its claim of being MSME, before its account is classified as NPA. If that is not done, and once the account is classified as NPA, the banks i.e. secured creditors would be entitled to take the recourse to Chapter III of the SARFAESI Act for the enforcement of the security interest.
17. It is also pertinent to note that sufficient safeguards have been provided under the said Chapter for safeguarding the interest of the Defaulters-Borrowers for giving them opportunities to discharge their debt. However, if at the stage of classification of the loan account of the borrower as NPA, the borrower does not bring to the notice of the concerned bank/creditor that it is a Micro, Small or Medium Enterprise under the MSMED Act and if such an Enterprise allows the entire process for enforcement of security interest under the SARFAESI Act to be over, or it having challenged such action of the concerned bank/creditor in the court of law/tribunal and having failed, such an Enterprise could not be permitted to misuse the process

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

of law for thwarting the actions taken under the SARFAESI Act by raising the plea of being an MSME at a belated stage. Suffice it to say, when it is mandatory or obligatory on the part of the Banks to follow the Instructions/Directions issued by the Central Government and the Reserve Bank of India with regard to the Framework for Revival and Rehabilitation of MSMEs, it would be equally incumbent on the part of the concerned MSMEs to be vigilant enough to follow the process laid down under the said Framework, and bring to the notice of the concerned Banks, by producing authenticated and verifiable documents/material to show its eligibility to get the benefit of the said Framework.

18. In that view of the matter, we are of the opinion that the findings recorded by the High Court in the impugned order that the Banks are not obliged to adopt the restructuring process on its own or that the Framework contained in the Notification dated 29.05.2015, as revised from time to time could not be said to be mandatory in nature, are highly erroneous and cannot be countenanced. The Instructions/Directions issued by the Central Government under Section 9 of the MSMED Act and by the RBI under Section 21 and Section 35A have statutory force and are binding to all the Banking companies.
19. The impugned order therefore is set aside. Since, it has been submitted by the Learned Counsels for the Respondents-banks that in all the cases, the proceedings under the SARFAESI Act have already been concluded and the possession of the respective premises of the petitioners has already been taken over, we do not propose to remand the matters to the High Court for deciding the Writ Petitions afresh. However, since the High Court has not dealt with the other issues based on the factual aspects of the writ petitions, we clarify that it would be open for the appellants to take recourse to any remedy as may be legally available to them for agitating the issues not decided by the High Court in the impugned order. All the appeals stand allowed to the aforesaid extent.

Result of the case: Appeals allowed.

[†]Headnotes prepared by: Divya Pandey