

# GRC BULLETIN

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## Case Law

Relief for MSMEs: Paying Off Loans Early  
Shouldn't Come at a Cost

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## JUDICIAL INSIGHT

# RELIEF FOR MSMEs: PAYING OFF LOANS EARLY SHOULDN'T COME AT A COST

### FACTS OF THE CASE

1. **Background of the Petitioner:** M/S Cottage Industries Exposition Ltd. (CIE), a company incorporated in 1978 under the Companies Act, has its registered office at Shalimar, Srinagar. The company has a long-standing business relationship with Jammu & Kashmir Bank and claims to have maintained a satisfactory credit history.
2. **Loan Sanctions by J&K Bank:**
  - On 27 June 2022, J&K Bank sanctioned a Term Loan of ₹19.63 crores to CIE under the Lease Rental Discounting Scheme, on a floating interest rate.
  - On 22 September 2022, the bank renewed a Cash Credit Facility on similar terms.
3. Both sanction letters included a stipulation of 4% prepayment charges if the loan was shifted to another bank, along with applicable GST.
4. **Petitioner's Objection:**
  - CIE accepted both loans but later sought to transfer the facilities to YES Bank, which sanctioned loans of ₹25 crores and ₹6 crores, respectively.
  - J&K Bank insisted on levying the 4% foreclosure charges, prompting the petitioner to file a writ petition challenging this clause.
5. **Petitioner's Key Arguments:**
  - The prepayment clause violates RBI guidelines, especially those under Section 21 and 35A of the Banking Regulation Act and Sections 9 and 10 of the MSME Development Act, 2006.
  - CIE claimed registration as a Small Enterprise under UDYAM on 25 July 2023 and invoked protections under MSME norms.
  - It relied on the RBI Circular dated 24 July 2017 and the Banking Codes and Standards Board of India (BCSBI) commitments that prohibit prepayment penalties for MSMEs and floating rate loans.

### ISSUES BEFORE THE COURT

1. Can the petitioner challenge the prepayment charges clause after accepting the loan with that condition?
2. Whether the RBI guidelines and directions, especially for MSMEs and individual borrowers, apply to the petitioner?

### Case Title

*[M/S Cottage Industries Exposition Ltd. v. Union of India & Ors., WP(C) No. 806/2024, decided on 04.06.2024 [Jammu & Kashmir High Court – Srinagar Bench]]*



# JUDICIAL INSIGHT

## Case Title

*[M/S Cottage Industries Exposition Ltd. v. Union of India & Ors., WP(C) No. 806/2024, decided on 04.06.2024 [Jammu & Kashmir High Court – Srinagar Bench]*

- Whether the petitioner's registration as an MSME after availing the loan entitles it to exemption from foreclosure charges?

### JUDGMENT AND ANALYSIS

#### **1. Doctrine of Estoppel Applies:**

- The Court held that since the petitioner had voluntarily accepted the terms of the sanction orders, including the prepayment clause, and availed the benefit of the loan, they cannot later challenge a clause simply because it is unfavourable.
- The doctrine of “approbate and reprobate” applies; one cannot accept the beneficial parts of a contract and reject the burdensome ones.

#### **2. MSME Status Not Retrospective:**

- The petitioner was not registered as an MSME when the loans were sanctioned in 2022.
- Registration was obtained only on 25 July 2023, and hence, benefits under the MSMED Act could not be claimed retrospectively.

#### **3. RBI Circular Not Applicable:**

- The 2015 Master Circular and 2017 Directions of the RBI prohibit prepayment charges only for individual borrowers and registered MSMEs.
- Since the petitioner is a company, not an individual or proprietorship, and was not an MSME at the time of sanction, these protections do not apply.

#### **4. No Violation of Public Policy or RBI Guidelines:**

- The Court found that RBI guidelines did not restrict J&K Bank from levying prepayment charges in the circumstances presented.
- The bank was within its rights to include such a clause in the sanction order.

#### **5. No Evidence of Loss Required Under Section 74:**

- The petitioner invoked Section 74 of the Indian Contract Act, arguing that the charges were penal and not compensatory.
- The Court held that there was insufficient pleading or evidence from the petitioner to show that no loss or lesser loss occurred due to prepayment, and hence, no relief under Section 74 could be granted.



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## 6. Distinction from Other Judgments:

- The Court distinguished the case from *Devendra Surana v. Bank of Baroda* (Calcutta HC), where the borrower was a sole proprietorship, not a company.
- Similarly, *DLF Ltd. v. Punjab National Bank* and other cases involving individual borrowers or different legal contexts did not apply.

## CONCLUSION

The writ petition was dismissed. The High Court upheld the 4% prepayment charge clause as valid, enforceable, and not in violation of RBI directions or public policy. The MSME benefits could not be extended retrospectively, and the petitioner was estopped from challenging terms it had voluntarily accepted.

This case reinforces the principle that contractual obligations voluntarily undertaken by parties cannot be undone unilaterally and that MSME protections under RBI and statutory laws apply prospectively, only from the date of valid registration. The judgment reiterates the judiciary's consistent approach in upholding **freedom of contract**, especially in **commercial loan agreements** between banks and companies.

## *CASE TITLE:*

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