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IN THE HIGH COURT OF DELHI AT NEW DELHI

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W.P.(C) No. 306/2019 & CM APPL. No. 7039/2019

APPLE SPONGE AND POWER LTD AND ORS Petitioners

Through : Mr. Dayan Krishnan, Senior
Advocate with Mr. Saurabh Kirpal,
Mr. Sameer Rohatgi, Mr. Ashish Batra
and Mr. Manohar Malik, Advocates.

versus

RESERVE BANK OF INDIA AND ANR Respondents

Through : Ms. Swati Setia, Advocate for RBI.

CORAM:

HON'BLE MR. JUSTICE ANUP JAIRAM BHAMBHANI

ORDER

% **15.02.2019**

CM APPL. No. 7039/2019 (for interim relief)

On 16.01.2019 notice was issued in this petition; and pleadings were directed to be completed. On 04.02.2019 further time was given for compliance of the previous order and the matter was posted to 03.04.2019.

2. In CM APPL. No. 1491/2019 seeking interim relief filed alongwith the petition, the petitioners had prayed as follows :

“a) Stay the effect and operation of the any action taken, contemplated or threatened of the Respondent No. 2 of categorizing the petitioners’ account as ‘fraud’ till the pendency of the present petition;”

At that time however no interim relief was granted.

3. By the present application, the petitioners contend that they have learned from a third party that the accounts of the petitioners with respondent No. 2/Bank have been classified as ‘fraud’ under



circular dated 01.07.2016 issued by respondent No. 1/RBI, which circular contains “Master Directions on Frauds —Classification and Reporting by commercial banks and select FIs”. It is further stated that the said accounts have also been reported as ‘fraud’ in RBI’s Central Repository of Information on Large Credits (CRILC) platform. The petitioners state that they were so informed by letter dated 31.01.2019 received from IndusInd Bank Ltd., when the said bank declined to open the petitioners’ bank accounts stating that the petitioners’ accounts have been reported as ‘fraud’.

4. Earlier each of the five petitioners had approached this court by way of separate writ petitions being W.P.(C) Nos. 5461/2018, 5482/2018, 5492/2018, 5449/2018, 5491/2018 claiming relief against the proceedings taken by respondent No. 2/Bank to declare the petitioners as ‘wilful defaulters’ in accordance with the RBI’s Master Circular dated 01.07.2015; which petitions were disposed of by separate orders, all dated 21.05.2018, made in each of the said cases, setting aside order dated 10.08.2016 made by respondent No. 2 declaring the petitioners as ‘wilful defaulters’ on the ground that the order contained no reasons and that the conclusions drawn had no link with the material considered by respondent No. 2. By the said orders dated 21.05.2018, respondent No. 2 was however given an opportunity to re-consider the issue of declaring the petitioners as ‘wilful defaulters’, after granting a hearing to the petitioners and passing speaking orders.

5. By order dated 21.05.2018 respondent No. 2 was granted eight weeks’ time to re-consider the matter of declaring the petitioners as



‘wilful defaulter’. Subsequently respondent No. 2 approached this court in some cases seeking enlargement of time to comply with orders dated 21.05.2018; which enlargement of time was granted; and it is stated that the process of declaring the petitioners as ‘wilful defaulters’ *is still under way*. Petitioners state that applications seeking enlargement of time have been filed in all cases but all such applications have not yet come-up before court ; in any case it is accepted by respondent No. 2 that the *proceedings for declaring the petitioners as wilful defaulters are still pending with the bank in all cases*.

6. Mr. Dayan Krishnan, learned Senior Counsel appearing for the petitioners states that while the process for re-considering the issue of declaring the petitioners as ‘wilful defaulters’ is still going on, respondent No.2/Bank has proceeded to declare the petitioners’ accounts as ‘fraud’ under the RBI Circular dated 01.07.2016.

7. Mr. Krishnan submits that : firstly, RBI’s Circular dated 01.07.2016 aforesaid deserves to be quashed *inter alia* for the reason that it provides a mechanism whereby an account can be declared ‘fraud’ without following the principles of natural justice; and furthermore, in the facts of this case, respondent No. 2 could not have declared the petitioners’ account as ‘fraud’ while the process for reconsidering the issue of petitioners being declared wilful defaulters was still underway.

8. Mr. Krishnan further submits that for each of the petitioners there are forensic audit reports which exonerate the petitioners from any wrongdoing.



9. The contentions and counter-contentions notwithstanding, in my *prima facie* view there clearly appears to be something amiss inasmuch as RBI's Master Directions dated 01.07.2016 relating to classification and reporting of 'fraud' does not contain any provision for issuance of show-cause notice or affording a hearing to the affected party, even though a decision by a bank, whether taken individually or collectively with other banks, to classify an account as 'fraud' is a significant administrative decision taken in the commercial realm, having serious consequences for the account holder. That is to say, while a bank may most certainly *report* fraudulent transactions in an account to law enforcement agencies under the criminal law regime *without* issuing a show cause notice or hearing an affected party, but if an account is to be *declared* 'fraud' by an administrative decision in the framework of civil law, such action it appears on first principles, cannot be taken without giving to the affected party an opportunity of hearing to show cause against it.
10. Upon a conspectus of the scheme established by the RBI, it transpires that declaring an entity as 'wilful defaulter' is covered by Circular dated 01.07.2015 issued by the RBI which defines 'wilful default' under clause 2.1.3 as under :

"2.1.3 Wilful Default : A 'wilful default' would be deemed to have occurred if any of the following events is noted:

- (a) The unit has defaulted in meeting its payment/repayment obligations to the lender even when it has the capacity to honour the said obligations.*
- (b) the unit has defaulted in meeting its*



payment/repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.

(c) The unit has defaulted in meeting its payment/repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.

(d) the unit has defaulted in meeting its payment/repayment obligations to the lender and has also disposed off or removed the movable fixed assets or immovable property given for the purpose of securing a term loan without the knowledge of the bank/lender.

The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions/incidents. The default to be categorised as wilful must be intentional, deliberate and calculated.” ;

(Emphasis supplied)

On the other hand classification of an account as ‘fraud’ is covered by Master Directions on Frauds dated 01.07.2016 issued by the RBI. Clause 2.2 of these directions, which defines and deals with the classification of frauds recites as under :

“2.2 Classification of Frauds

2.2.1 In order to have uniformity in reporting, frauds have been classified as under, based mainly on the provisions of the Indian Penal Code:



- a. Misappropriation and criminal breach of trust.*
- b. Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.*
- c. Unauthorised credit facilities extended for reward or for illegal gratification.*
- d. Cash shortages.*
- e. Cheating and forgery.*
- f. Fraudulent transactions involving foreign exchange*
- g. Any other type of fraud not coming under the specific heads as above.*

2.2.2 As regards cases under d) and f) above cash shortages resulting from negligence and fraudulent forex transactions involving irregularities / violation of regulations have also to be reported as fraud if the intention to cheat/defraud is suspected or proved. Notwithstanding the above, the following cases shall be treated as fraud and reported accordingly:

- a. cases of cash shortage more than ₹10,000/-, (including at ATMs) and*
- b. cases of cash shortage more than ₹5,000/- if detected by management/auditor/inspecting officer and not reported on the day of occurrence by the persons handling cash”*

(Emphasis supplied)

11. It is noteworthy that while the RBI circular dealing with ‘wilful defaulters’ provides a mechanism whereby a hearing is given to the affected party, no opportunity of hearing appears to be available in the circular that deals with declaring an account as ‘fraud’, which latter is a much more serious matter.
12. Issue notice on this application, returnable 26.04.2019.



13. Mr. Rajender Wali, learned counsel for respondent No. 2/Bank appear on advance copy and accepts notice.

14. He contends that the matter of declaring an entity as ‘wilful defaulter’ is different and distinct from that of declaring an account as ‘fraud’, the two matters are covered by different master circulars; and the mechanisms therefor cannot be compared. Counsel for respondent No. 2 draws attention to Clause 8.9.4 of RBI’s Master Directions dated 01.07.2016, which reads as under :-

“8.9.4 The initial decision to classify any standard or NPA account as RFA or Fraud will be at the individual bank level and it would be the responsibility of this bank to report the RFA or Fraud status of the account on the CRILC platform so that other banks are alerted. In case it is decided at the individual bank level to classify the account as fraud straightaway at this stage itself, the bank shall then report the fraud to RBI within 21 days of detection and also report the case to CBI/Police, as is being done hitherto. Further within 15 days of RFA/Fraud classification, the bank which has red flagged the account or detected the fraud would ask the consortium leader or the largest lender under MBA to convene a meeting of the JLF to discuss the issue. The meeting of the JLF so requisitioned must be convened within 15 days of such a request being received. In case there is a broad agreement, the account should be classified as a fraud; else based on the majority rule of agreement amongst banks with at least 60% share in the total lending, the account should be red flagged by all the banks and subjected to a forensic audit commissioned or initiated by the consortium leader or the largest lender under



MBA. All banks, as part of the consortium or multiple banking arrangement, shall share the costs and provide the necessary support for such an investigation.”

(Emphasis supplied)

15. Mr. Wali accordingly contends that there is no requirement of a show cause notice or hearing before declaring an account as ‘fraud’ in the afore-stated RBI Master Circular.

16. Considering the submissions made, I see merit in the petitioners’ contention that when the case of the petitioners being declared *wilful defaulters* is still under consideration by respondent No. 2, since the bank’s earlier decision in that behalf was set-aside by this court, the bank cannot *straightaway* declare the petitioners’ accounts as ‘fraud’ without so much as a show cause notice and without giving a hearing.

17. To me it *prima facie* appears that declaring an account as ‘fraud’ would arise in a case of egregious default on the part of an account holder, something more than the account holder being a ‘wilful defaulter’. For an account to be declared as ‘fraud’ must entail an element of *criminality* on the part of the account holder, which ought to be inferred *only* on the basis of some substantial material which must be put to the errant account holder; and after considering any explanation such account holder has to offer; and not unilaterally by a stroke of the pen.

18. Considering the past proceedings in this case, the hasty manner in which the bank has proceeded to classify the petitioners’ accounts



as ‘fraud’ also appears to be an effort to over-reach the orders of this court and nullify the pending process of declaring the petitioners ‘wilful defaulters’.

19. In the circumstances, without prejudice to the rights and contentions of the parties, all of which are kept open, it is directed that respondent No. 2/bank shall *not* take any further steps or actions prejudicial to the petitioners based upon the petitioners’ account being declared ‘fraud’ until the next date of hearing.

20. Let notice be issued to respondent No.1/RBI by all permissible modes, returnable on the next date.

21. Let pleadings in the matter be completed and reply/ies be also filed in this application within four weeks; rejoinder/s thereto if any, be filed within three weeks of receiving the reply/ies.

22. Re-list on 26.04.2019.

23. The date of 03.04.2019 given earlier in the matter stands cancelled.

Dasti.

ANUP JAIRAM BHAMBHANI, J

FEBRUARY 15, 2019

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