

IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

Civil Writ Petition No.13888 of 2015 (O&M)
DATE OF DECISION: 11.04.2016

M/s Oswal Spinning & Weaving Mills Ltd.

....Petitioner

versus

Reserve Bank of India and others

.....Respondents

CORAM:- HON'BLE MR.JUSTICE S.J. VAZIFDAR, ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE ARUN PALLI

Present: Mr. Aalok Jagga, Advocate and
Mr. Karanyog Singh Riar, Advocate
for the petitioner

Mr. Rajiv Atma Ram, Senior Advocate with
Mr. Bhavpreet Singh Dhatt, Advocate and
Mr. Manish Jain, Advocate for respondent
Nos.2 and 3

..

S.J. VAZIFDAR, ACTING CHIEF JUSTICE:

The petitioner seeks a writ of certiorari to quash a demand notice dated 04.04.2014 issued by respondent No.2-Kotak Mahindra Bank Limited under Section 13(2) of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the reply submitted by respondent No.2 under Section 13(3A) of the Act pursuant to the orders of this Court in CWP No.10957 of 2014. The writs are sought on the ground that the impugned orders are without jurisdiction. Respondent No.3 is the Chief Manager of respondent No.2.

The petitioner has also sought a writ of mandamus directing the respondents to upgrade its loan account *i.e.* Export Packing Credit (EPC) to a standard loan account from the Non-

Performing Asset (NPA) category. This writ is sought on the basis of a Master Circular issued by respondent No.1-Reserve Bank of India.

2. We would normally have relegated the petitioner to the alternate remedy of filing an appeal under Section 17 of the SARFAESI Act. However, Mr. Jagga, the learned counsel appearing on behalf of the petitioner restricted his submissions in this case to a purely jurisdictional issue. We are inclined to entertain the writ petition on that issue alone. We have decided the issue against the petitioner. As far as the merits are concerned, the petition is disposed of with liberty to the petitioner to avail the alternate remedy.

3. In November, 2007, respondent No.2 acquired the debts of an aggregate amount of over Rs.53 crores of the petitioner from six lenders. The petitioner requested respondent No.2 to reschedule the payment. Respondent No.2 acceded to the request as per the terms and conditions contained in a Letter of Acceptance (LOA) dated 26.12.2007. The petitioner accepted the same. The essential terms of the LOA included interest @ 17.5% per annum, a repayment period of 38 months, penal interest @ 3% per annum and Rs.10 crores as penalty in case of default. According to respondent No.2, the petitioner repaid only an amount of Rs.5.35 crores in the following two years.

The petitioner requested the repayment to be further rescheduled on account of certain difficulties faced by it. In September, 2009, respondent No.2 issued a revised LOA, which was accepted by the petitioner. In the revised LOA, the petitioner accepted its debt of Rs.47.28 crores which included principal outstanding, default penalty of Rs.10 crores and outstanding

interest. The payments were to be made quarterly from December, 2009 to March, 2013 as per the schedule annexed with interest at 17 per cent per annum. Penal interest @ 3% per annum compounded quarterly and other charges were payable. The residential property of the promoters was mortgaged as security for repayment of the dues.

The petitioner accepted the revised LOA dated 30.09.2009. The parties acted upon the terms of the revised LOA. This, therefore, constituted one facility which we will for convenience refer to as the first facility or account.

4. Thereafter, respondent No.2 itself sanctioned a revolving Export Packing Credit Facility (EPC Facility) in favour of the petitioner of an amount of Rs.5 crores. The petitioner admittedly failed to adhere to the terms and conditions thereof. As a result, on 17.12.2013, respondent No.2 classified the petitioner's account as an NPA. Respondent No.2 contends that the classification was borrower-wise and not facility-wise.

5. Mr. Jagga, the learned counsel appearing on behalf of the petitioner, relied upon paragraph-10 of an affidavit-in-reply filed by respondent No.2 in an earlier writ petition filed by the petitioner being CWP No.10957 of 2014 to contend that the first facility is not an NPA. Paragraph-10 reads as under:-

"10. I further say that as per the RBI guidelines for income recognition for NPA buy-outs, no income can be booked in case of NPA buyouts unless 100% principal is recovered. As mentioned above, the Petitioner made payment of the 100% principal to the Respondent No.2 but failed to make payment of delayed interests and other charges as mutually agreed in the revised LOA dated September 30, 2009. Accordingly, in spite of non-payment of interest and penal interest as per the revised LOA, the account of the Petitioner account could not be declared as NPA since principal outstanding was repaid and accordingly, the Bank

issued a letter in February 2013 (Annexure P-5) to the Petitioner certifying that the account is a Standard Asset."

6. The petitioner failed to repay the entire dues under both the accounts. Mr. Jagga, however, emphasised the fact that the 2nd respondent admitted that the entire principal amount in the first account had been paid and that respondent No.2 had itself admitted that the first account could, therefore, not be declared as an NPA. To establish that, in view of what transpired thereafter, neither of the accounts could be declared a NPA, Mr. Jagga relied upon the fact that the petitioner had also repaid the entire amount due under EPC account. An earlier Division Bench passed the following interim order dated 15.07.2015:-

"Learned counsel for the petitioner argued that the default of Rs.1,57,45,000/- on account of Export Packing Credit facility is the basis of issuance of notice under Section 13(2) of the Securitization and Reconstruction of Financial Asset and Enforcement of Security Interest Act, 2002 (for short 'the Act'). Though the said default is disputed by the petitioner but to avoid the proceedings under the Act, the petitioner is ready and willing to pay the said amount without prejudice to its rights within one month, half of which will be deposited within one week from today.

Notice of motion for 29.07.2015.

Process dasti only.

On deposit of half of the alleged defaulted amount of Export Packing Credit facility, the Bank shall not proceed for issuance of notice under Section 13(4) of the Act."

It is admitted that pursuant to the said order, the petitioner paid the amount due under the EPC facility.

7. The question, therefore, is whether in view the fact that the entire principal amount under the first account had been repaid and the entire amount due under the EPC facility had been repaid the petitioner's account can still be classified as an NPA

under the Reserve Bank circular. The relevant provisions of the Master Circular issued by respondent No.1-RBI are as follows:-

"4.2.5 Upgradation of loan accounts classified as NPAs

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts. With regard to upgradation of a restructured/rescheduled account which is classified as NPA contents of paragraphs 12.2 and 15.2 in the Part B of this circular will be applicable.

....

4.2.7 Asset Classification to be borrower-wise and not facility-wise

i) It is difficult to envisage a situation when only one facility to a borrower/one investment in any of the securities issued by the borrower becomes a problem credit/investment and not others. Therefore, all the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment or part thereof which has become irregular."

8. Before dealing with the submissions it is necessary to deal with Mr. Jagga's submission that it is always permissible for a borrower to take its account out of the category of NPA and into the category of a standard account. In other words, according to him, it does not follow that if an account is once classified an NPA it always remains an NPA. We agree. His reliance upon the judgment of a Division Bench of the Andhra Pradesh High Court in the case of *Sravan Dall Mill P. Limited vs. Central Bank of India & Anr*, 2010 AIR (A.P.) 35 in this regard is well founded. The relevant clause of the Master Circular then in force and considered in the judgment reads as under:-

"4.2.4 Upgradation of loan accounts classified as NPAs: If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts. With regard to upgradation of a

restructured/rescheduled account which is classified as NPA contents of paragraphs 4.2.14 and 4.2.15 will be applicable."

The Division Bench held:-

"23.
It also cannot be disputed that even assuming that particular (*sic* account) had become NPA, the subsequent payments by the borrower entitled a borrower to upgrade the said account and may come out of the said classification of his account as NPA. Therefore, it is incorrect to presume that once an NPA is always an NPA and it is precisely for the said reason that the clause 4.2.4 of the prudential norms specifically states that if interest and principal are paid by the borrower in case of loans classified as NPA, the said account should no longer be treated as NPA and may be classified as sub-standard account. Consequently, therefore, the action under the SARFAESI Act with regard to the said account would not be tenable, as jurisdictional fact under Section 13(2) of the SARFAESI Act would remain unsatisfied."

9. Clause 4.2.5 which falls for our consideration is similar to Clause 4.2.4 which fell for the consideration of the Andhra Pradesh High Court. We are in respectful agreement with these observations in the judgment. The entire purpose of the circular and the policy contained therein would be defeated if a view to the contrary is taken. The circular does not condemn an account as an NPA merely on account of non-payment. Detailed parameters are provided in the circular for an account to be classified an NPA. Further, the accounts of various organizations have been categorized differently. In Clause-4, for instance, banks are required to classify non-NPAs into three categories, namely, sub-standard assets, doubtful assets and loss assets, based on the period for which the assets have remained non-performing and the realisability of the dues. This is an indication against the view that once

an account is considered NPA it remains a NPA throughout irrespective of anything.

10. Further, to have an account upgraded from an NPA to a standard account, it is not necessary that the entire amounts due from the borrower to a creditor are paid in full. It is sufficient if the amounts due at the material time towards principal and interest are paid. This is clear from the opening words of the first sentence of Clause 4.2.5 of the Master Circular - "If arrears of interest and principal are paid by the borrower". These words clearly indicate that payment of the amounts due at a particular point of time towards interest and principal is sufficient for the account not to be treated any longer as an NPA and to have the same classified as a standard account. If it were otherwise, the clause would have been worded entirely differently. It would have required the borrower to pay all the dues of the lender. Indeed, in that event, there would be no question of reclassifying the account from an NPA to a standard account for upon repayment the account would stand closed. Clause 4.2.5 contemplates the continuation of the accounts and not the closure thereof.

11. We are, however, unable to agree with Mr. Jagga's contention that merely upon the payment of the amounts due under the EPC account, the petitioner's account no longer remained an NPA and was liable to be classified as a standard account. The manner in which the account is to be upgraded from NPA to standard is stipulated in the Master Circular itself. The account can be so classified only in the event of

the borrower paying the arrears of interest and principal due to the lender under all the accounts. This is clear firstly from the title of Clause 4.2.7 - 'Asset classification to be borrower-wise and not facility-wise' upon which Mr. Rajiv Atma Ram, the learned senior counsel, appearing on behalf of respondent No.2, rightly placed reliance. Further, sub-clause (ii) of 4.2.7 expressly provides that all the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA and not the particular facility or part thereof which has become irregular. The title to Clause 4.2.7 itself states the asset classification to be borrower-wise and not facility-wise. The petitioner has admittedly not paid the arrears due in respect of his first account. The petitioner's account, therefore, cannot be upgraded from an NPA to a standard account.

12. The notice issued by the 2nd respondent under the SARFAESI Act cannot, therefore, be said to be without jurisdiction merely on account of the petitioner having paid the amount under the EPC account.

13. Faced with this, Mr. Jagga relied upon section 31(j) of the SARFAESI Act which reads as under:-

"31. Provisions of this Act not to apply in certain cases.- The provisions of this Act shall not apply to-

(a) to (i)

(j) any case in which the amount due is less than twenty per cent of the principal amount and interest thereon."

Mr. Jagga contended that the provisions of the Act would apply only if at least 20% of the principal as well as 20% of the interest is due. He submitted that even if in the first account more than 20% of the interest is due the provisions of the SARFAESI Act could not apply as no amount towards principal is due.

14. The submission is contrary to the plain language of Section 31(j). If not less than 20% of the amount is due under the account whether towards principal or towards interest, the Act would apply. If it were otherwise, as suggested by Mr. Jagga, the section would have been worded entirely differently. It would have provided that the Act would not apply if the amount due is less than 20% of the principal or even if the amount due is less than 20% of the interest.

This is also clear from the last word in the Section "thereon". The words "interest thereon" indicate that the ceiling of 20% is with respect to the aggregate amount due to the bank towards principal and/or interest. The ceiling of 20% is not with respect to the principal amount alone or to the interest alone. This would be so even if pursuant to an arrangement between the parties, the receipts are adjusted towards principal and no amount towards principal is due. Interest, penal or regular, simple or compounded is on the principal. This is so even if the principal amount is subsequently not due, for the interest was on or qua the principal.

15. Mr. Jagga raised certain other issues including that penal interest cannot be compounded. Even assuming that he is

right in this regard, it would still be necessary to examine whether even after leaving aside penal interest the amounts exceed the limit prescribed in Section 31(j). It is, therefore, not a pure question of jurisdiction.

16. In the circumstances, the petition is disposed of with the above observations. It will, however, not be open to the petitioner to raise the contentions that we have decided in any alternate remedy that the petitioner may resort to, such as, under Section 17 of the SARFAESI Act. The petitioner is at liberty to raise the other defences by resorting to the alternate remedy under Section 17 of the SARFAESI Act.

(S. J. VAZIFDAR)
ACTING CHIEF JUSTICE

11.04.2016
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(ARUN PALLI)
JUDGE

<u>Note</u>: Whether reportable: YES
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