

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved on	08/08/2019
Delivered on	29/08/2019

CORAM:

THE HONOURABLE MR. JUSTICE K.KALYANASUNDARAM

W.P.No.43433 of 2016 &

W.M.P.No.37294 of 2016

V.Selvaraj ... Petitioner

Vs

- 1.The Reserve Bank of India,
Department of Non-Banking Supervision,
Fort Glacis, Rajaji Salai,
Chennai - 600 001.
Rep. by its Assistant General Manager.
- 2.The Chairman & Managing Director,
State Bank of Mysore,
Head Office,
646, K.G.Road,
Bangalore - 560 009.
- 3.State Bank of India,
Represented by its Chief Manager,
Industrial Finance Branch,
No.231, NSC Bose Road (1st Floor),
Chennai - 600 001.
(R-3 amended as per order dated 13.09.2017
in W.M.P.No.18661 of 2017 in
W.P.No.43433 of 2016)
- 4.M/s.First Leasing Company of India Ltd. (FLCI),
No.749, Anna Salai,
Chennai - 600 002.
Rep. by its Provisional Liquidator /
Official Liquidator. ... Respondents

Prayer:- The Writ Petition is filed under Article 226 of the Constitution of India, seeking for a Writ of Certiorarified Mandamus, to call for the records relating to the letter bearing Ref. No.IFBC:ADV:FLCIL, dated 10.05.2016 on the file of the third respondent and quash the same and consequently direct the respondents herein to declassify the petitioner from the list of Wilful Defaulters.

For Petitioner : Mr.G.Masilamani,
Senior Counsel
For Mr.Mani Sundaragopal

For Respondents : Mr.C.Mohan
For M/s.King and Patridge for R1

Mr.S.Sethuraman for R2 & R3

Notice returned (R4)

O R D E R

The petitioner has come forward with this Writ Petition for issuance of Writ of Certiorarified Mandamus to call for the records relating to the letter bearing Reference No.IFBC:ADV:FLCIL, dated 10.05.2016 of the third respondent and quash the same and consequently direct the respondents to declassify the petitioner from the List of Wilful Defaulters.

2. The petitioner would state that he is a retired IAS Officer of 1964 Batch and he held several posts in the State Government and the Central Government. He was also connected with several International Organizations and took voluntary retirement from the Government in the year 1989 and thereafter, he was in the Board of several Companies, Educational Institution and Non-Profit Philanthropic Institutions.

3. The petitioner would further state that the fourth respondent is a Public Limited Company, incorporated under the provisions of the Companies Act, 1956 on 10.09.1973. The Company was engaged in the business of leasing, hire purchase and financing. The concept of establishing a leasing Company was the brain child of one Mr.Farouk Irani, who was the Founder Member and Managing Director of the fourth respondent. He was in absolute control of the entire affairs and working of Company right from its inception. The day-to-day operations of the Company are looked after by the said Mr.Farouk Irani and he also acted as a heads of all the Departments, viz., financial, accounting and etc., and no other Officer of the Company interfered in the over all control of the company by the Managing Director. The petitioner states that he was invited to join the Board of the fourth respondent-Company in the year 2012 and he joined as a Non-Executive Independent Director on 14.08.2012.

4. The petitioner further states that the Reserve

Bank of India during annual inspection conducted in the year 2013 into the books of accounts of the fourth respondent-Company, found accounting malpractices in the Company and issued various direction in order to protect the public interest. Thereafter, on 16.09.2013, the fourth respondent had taken a decision to appoint a Former Director, Central Bureau of Investigation Dr.R.K.Raghavan, to carry out Forensic Audit into the affairs of the Company and also appointed a Special Audit Team. The first respondent also appointed M/s.N.C.Rajagopal & Company, Chartered Accountants to carry out Special Audit into the books of accounts of the Company for its transaction between 01.04.2002 and 31.02.2013. The consortium of Bankers had appointed M/s.Maharaj, N.R.Suresh & Co., Chartered Accountants in the meeting held on 25.11.2003 and they submitted a final report on 24.01.2014.

5. The petitioner would allege that the said Farouk Irani and his Team developed a software to create fictitious data / entries in the Companies account. The Forensic Audit conducted by Dr.R.K.Raghavan, submitted a final report on 28.07.2014, stating that the Managing Director of the Company has been identified for all the misdeeds and recommended to lodge criminal action to unearth the fraud committed by him and his team of employees.

6. The petitioner would state that during the check period, he attended 4 Board meetings of the Company. When the Managing Director and the Company's Statutory Auditors reported that financial results of the Company was very good and accounts were certified to be maintained properly as per the accounting standards by the Statutory Auditors, neither the petitioner nor the Board of Director had reason to suspect any foul play and only after the Special Audit conducted by the Reserve Bank of India and other Agencies, the misdeeds of the Managing Director and his chosen Officers of the Company came to light only during September 2013.

7. It is a case of the petitioner that he had no role in either verifying the accounts or in maintaining accounts of the Company. He had no knowledge about the fabrication of accounts and he had also no way of knowing the window dressing of the accounts of the Company. While so, the State Bank of Mysore, one of the creditors of the fourth respondent-Company had declared the assets of the fourth respondent as a non-performing on 31.12.2013. Subsequently, the said bank issued a letter dated 30.09.2014 to the Company and its Directors, stating that

an appropriate committee of the Bank had examined the violations of the terms and conditions and had approved the proposal for inclusion of the name(s) of the Company and it is Directors / Guarantors in the Reserve Bank of India / Credit Information Bureau of India Limited [CIBIL] list of Wilful Defaulters and in case of any grievance, they can send a representation within a period of 15 days to the Grievance Redressal Committee of the Bank at their Headquarters. In response to the letter, the petitioner submitted a detailed reply dated 11.10.2014, stating that the petitioner's name is not to be included in the list of wilful defaulters. He also sent another representation dated 14.01.2015, categorically stating that since he neither a Whole Team Director nor a Promoter of the Company, he cannot be declared as a wilful defaulter.

8. The petitioner would claim that the third respondent sent another letter dated 26.11.2015 to include the name of the Directors in the list of wilful defaulters, for which, the petitioner submitted a representation on 09.12.2015 and also participated in the enquiry and gave a detailed explanation about his non-involvement in the alleged illegalities committed by the Company, however without considering the same, by the impugned letter dated 10.05.2016, the petitioner has been classified as a wilful defaulter on 25.04.2016.

9. Mr.G.Masilamani, learned Senior Counsel appearing on behalf of the petitioner would urge that admittedly the petitioner joined in the fourth respondent-Board as Non-Executive Independent Director of the Company. The learned Senior Counsel by referring Sections 149 (6) and 149(12) of the Act, submitted that an Independent Director shall be held liable, only in respect of such acts of omission or commission by a Company which had occurred with his knowledge, consent or connivance; that the petitioner never involved in the day-to-day affairs of the Company and no material is available to hold that the illegality of the company has taken place with his consent and connivance, the petitioner cannot be declared as a 'wilful defaulter'. The learned Senior Counsel relies on the Master Circular issued by the Reserve Bank of India, dated 01.07.2015 in support of the above contentions.

10. It is further submitted that by declaring a person as a 'wilful defaulter' has a serious consequences and it also causes social stigma. He further added that on the same set of materials, the State Bank of India, by

its letter dated 13.07.2016, intimated that the Wilful Defaulter Identification Committee decided not to include the name of the petitioner in CICs list of Wilful Defaulters. The State Bank of Mysore has now been merged with the State Bank of India and that the impugned cryptic order has been passed in a mechanical manner, without considering the provisions of law, Statute, and the replies submitted by the petitioner, hence, the impugned order is to be quashed.

11. Mr.C.Mohan, learned counsel for the first respondent submitted that the Master Circular relied on by the petitioner has been issued under the Reserve Bank of India Act, and hence, it is a Statutory Notification. It is further contended by the learned counsel that the Circular has been upheld by the Hon'ble Apex Court.

12. The learned counsel for the third respondent would state that during the pendency of the Writ Petition, the State Bank of Mysore has been merged with the State Bank of India and thereafter, the petitioner gave a representation as per the order of this Court, but so far no final decision could be taken due to the non convening of the Committee.

13. Heard both sides and perused the materials available on record.

14. The relevant provisions of the Act and Circular are extracted hereunder for ready reference:-

Sections 149 (6) of the Companies Act:-

6) An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,-

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(d) none of whose relatives has or had pecuniary relationship or transactions with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent, or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(e) who, neither himself nor any of his relatives-

(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of-

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with his relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

(f) who possesses such other qualifications as may be prescribed.

Section 149(12) of the Companies Act:-

"12. Notwithstanding anything contained in this Act,-

(i) an independent director;

(ii) a non-executive director not being promoter or key managerial personnel,

shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently."

Clauses 2.5 and 3 of Master Circular:-

2.5 Penal measures:-

"The following measures should be initiated by the banks and FIs against the wilful defaulters identified as per the definition indicated at paragraph 2.1.3:

a) No additional facilities should be granted by any bank / FI to the listed wilful defaulters. In addition, such companies (including their entrepreneurs / promoters) where banks / FIs have identified siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from the scheduled commercial banks, Financial Institutions, NBFCs, for floating new ventures for a period of 5 years from the date of removal of their name from the list of wilful defaulters as published / disseminated by RBI/CICs.

b) The legal process, wherever warranted, against the borrowers / guarantors and foreclosure of recovery of dues should be initiated expeditiously. The lenders may initiate criminal proceedings against wilful defaulters, wherever necessary.

c) Wherever possible, the banks and FIs should adopt a proactive approach for a change

of management of the wilfully defaulting borrower unit.

d) A covenant in the loan agreements, with the companies to which the banks / FIs have given funded / non-funded credit facility, should be incorporated by the banks / FIs to the effect that the borrowing company should not induct on its board a person whose name appears in the list of Wilful Defaulters and that in case, such a person is found to be on its board, it would take expeditious and effective steps for removal of the person from its board.

It would be imperative on the part of the banks and FIs to put in place a transparent mechanism for the entire process so that the penal provisions are not misused and the scope of such discretionary powers are kept to the barest minimum. It should also be ensured that a solitary or isolated instance is not made the basis for imposing the penal action."

3. Mechanism for identification of Wilful Defaulters:-

"The mechanism referred to in paragraph 2.5 above should generally include the following:-

(a) The evidence of wilful default on the part of the borrowing company and its promoter/whole-time director at the relevant time should be examined by a Committee headed by an Executive Director or equivalent and consisting of two other senior officers of the rank of GM/DGM.

(b) If the Committee concludes that an event of wilful default has occurred, it shall issue a Show Cause Notice to the concerned borrower and the promoter/whole-time director and call for their submissions and after considering their submissions issue an order recording the fact of wilful default and the reasons for the same. An opportunity should be given to the borrower and the promoter/whole-time director for a personal hearing if the Committee feels such an opportunity is necessary.

(c) The Order of the Committee should be reviewed by another Committee headed by the Chairman / Chairman & Managing Director or the Managing Director & Chief Executive Officer / CEOs and consisting, in addition, to two independent directors / non-executive directors of the bank and the Order shall become final only after it is confirmed by the said Review Committee. However, if the Identification Committee does not pass an Order declaring a borrower as a wilful defaulter, then the Review Committee need not be set up to review such decisions.

(d) As regard a non-promoter/non-whole time director, it should be kept in mind that Section 2(60) of the Companies Act, 2013 defines an officer who is in default to mean only the following categories of directors:

(i) Whole-time director

(ii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;

(iii) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings and who has not objected to the same, or where such contravention had taken place with his consent or connivance.

Therefore, except in very rare cases, a non-whole time director should not be considered as a wilful defaulter unless it is conclusively established that

I. he was aware of the fact of wilful default by the borrower by virtue of any proceedings recorded in the Minutes of the Board or a Committee of the Board and has not recorded his objection to the same in the Minutes, or,

II. the wilful default had taken place with his consent or connivance.

The above exception will however not apply to a promoter director even if not a whole time director.

(iv) As a one-time measure, Banks / FIs, while reporting details of wilful defaulters to the Credit Information Companies may thus remove the names of non-whole time directors (nominee directors / independent directors) in respect of whom they already do not have information about their complicity in the default / wilful default of the borrowing company. However, the names of the promoter directors, even if not while time directors, on the board of the wilful defaulting companies cannot be removed from the existing list of wilful defaulters.

(e) A similar process as detailed in sub paragraphs (a) to (c) above should be followed when identifying a non-promoter/non-whole time director as a wilful defaulter."

15. A plain reading of the above provisions would reveal that Section 149(6) prescribes the qualification of the Independent Director of a Company and it further distinguishes the Independent Director from the Managing Director or Whole-time Director or a Nominee Director of a Company. Section 149(12) deals with the responsibility and liability of the Independent Director. Clause 2.5 of the Master Circular of Reserve Bank of India, dated 01.07.2015, refers to penal measures to be initiated by the banks and financial institutions, after a person is declared as a 'wilful defaulter'. Clause 3, prescribes, mechanism for identification of Wilful Defaulters.

16. In the present case, it is not disputed that the check period was from 01.04.2002 to 31.02.2013 and out of the 11 years, the petitioner acted as an Independent Non-Executive Director for a period of seven months, i.e, between 14.08.2012 and 31.03.2013 and during that period, he participated in 4 Board Meetings of the Company. It is the specific case of the petitioner that the fourth respondent-Company was incorporated in the month of September 1973 and Mr.Farouk Irani was the Founder Member and Managing Director of the Company and he was heading all the Departments of the Company, including Finance and accounts and his decision was final and nothing is

available to implicate the petitioner for the misdeeds committed by the Managing Director of the Company.

17. Section 149 (12) of the Act makes it very clear that an Independent Director shall be held responsible only in respect of such acts of commission or omission by a Company which occurred with his knowledge, consent or connivance, but in the matter on hand, it is apposite to note that no materials have been brought on record to show that the petitioner actively participated in the day-to-day affairs of the Company or in the Board Meeting and the commissions and omissions alleged against the Company had taken place with the knowledge, consent or connivance of the petitioner to satisfy the ingredients of Section 149(12) of the Act. The learned Senior Counsel pointed out that the investigation report of Dr.R.K.Raghavan, Former Director, CBI, supports the case of the petitioner.

18. It is to be seen that the persons identified as wilful defaulter have to meet the consequence of the subsequent proceedings to be initiated by the Banks and Financial Institutions in tune with the Master Circular 2.5, referred supra. Therefore, unless the allegations are supported by material documents, no one can be declared as a 'wilful defaulter'. It is settled position of law that the penal provisions requires strict proof and it cannot be permitted to be exercised in a casual manner.

19. It is to be further seen that the Wilful Defaulter Identification Committee of the State Bank of India, after perusing the entire records came to the conclusion that they are not sufficient to declare the petitioner as a 'wilful defaulter'. In the case on hand, as observed above, there is absolutely no evidence available to declare the petitioner as a 'wilful defaulter'. Moreover, the explanation offered by the petitioner was not considered and the decision was taken against the provisions of the Act and Clause 3 of the Master Circular issued by the Reserve Bank of India.

20. Taking note of the facts of this case and the discussions supra, in the considered opinion of this Court, the petitioner is entitled to succeed in this Writ Petition. In that view, the order impugned in this Writ Petition is set aside and the Writ Petition is allowed as

prayed for. There is no order as to costs. Consequently,
connected miscellaneous petition is closed.

Sd/-
Assistant Registrar(insp cell)

//True Copy//

Sub Assistant Registrar

r n s

To

- 1.The Assistant General Manager.
Reserve Bank of India,
Department of Non-Banking Supervision,
Fort Glacis, Rajaji Salai,
Chennai - 600 001.
- 2.The Chairman & Managing Director,
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Bangalore - 560 009.
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State Bank of India,
Industrial Finance Branch,
No.231, NSC Bose Road (1st Floor),
Chennai - 600 001.

+1cc to M/s.King and partidge , Advocate SR.No. 74708

+1cc to Mr.S.Sethu raaman , Advocate SR.No. 74894

+2ccs to Mr.Mani sundar gopal , Advocate SR.No. 74771

W.P.No.43433 of 2016 &

W.M.P.No.37294 of 2016

pm

A.SK(09/10/2019)

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