

**IN THE HIGH COURT OF PUNJAB AND HARYANA AT
CHANDIGARH**

CWP No. 16490 of 2018

Date of decision: May 17, 2019

M/s Amar Alloys Pvt. Limited (Regd.)

.....Petitioner

Vs.

State Bank of India

.....Respondent

**CORAM: HON'BLE MR. JUSTICE AJAY KUMAR MITTAL
HON'BLE MRS. JUSTICE MANJARI NEHRU KAUL**

Present: Ms. Supriya Garg, Advocate for the petitioner.
Mr. Vikas Chatrath, Advocate for the respondent.

Ajay Kumar Mittal,J.

1. Through the instant writ petition filed under Article 226 of the Constitution of India, the petitioner-company prays for setting aside the action of the respondent Bank vide letter/email dated 27.6.2018, Annexure P.8, of classifying its account as Non Performing Asset (NPA).

2. A few facts relevant for the decision of the controversy involved as narrated in the petition may be noticed. The petitioner is a company registered under the Companies Act, 1956. It is engaged in the business of manufacture and production of food products and food grains. It was incorporated on 3.8.1989. In September 2007, it applied to the respondent State Bank of India to avail cash credit facilities against its stock statement and book debt. Further, factory land and building measuring 11 bigha 4 biswa bearing Hadbast No.257, Opposite Gian Sagar Nursing Home,

Village Rama Nagar, District Patiala was also given as collateral security by the petitioner to avail such credit facilities from the respondent-Bank. The respondent Bank on the basis of worth of stock in the stock statement and book credit sanctioned cash credit facilities to a limit of ₹ 4 crores. Since 2007, the respondent Bank had been renewing yearly the account of the petitioner company on the basis of its stock statement and book debt which is provided by the company on a monthly basis to the Bank. According to the petitioner, the respondent Bank even raised the cash credit limit to the extent of ₹ 13 to ₹ 17 crores in the year 2014 on the basis of stock statement and book debt of the petitioner company. The renewal of the petitioner's account with cash credit facility upto a limit of ₹ 4.80 crores was sanctioned by the bank on 22.3.2017. The petitioner's account was renewed in 2018. The petitioner asserts that it had a healthy relation with the respondent Bank and had never defaulted or delayed in making repayments against the sanctioned credit facility. The petitioner submitted its stock statements and book debt with the respondent Bank on a monthly basis so as to ensure smooth functioning. The Bank even issued certificate dated 7.5.2018 stating that its account was running satisfactorily. To the utter surprise of the petitioner, the respondent Bank vide email dated 27.6.2018 informed it that its account had been declared NPA as on 31.3.2018 by the central statutory auditor and was further advised to deposit the entire outstanding amount in the account. The respondent Bank issued two account statements of the petitioner for the month of June 2018 wherein one statement showed the drawing power to ₹ 4.80 crores and the other statement suddenly showed drawing power as zero. The petitioner vide letter/notice dated 29.6.2018, Annexure P.11 asked the bank about the reasons assigned for declaration of the petitioner's account as NPA and that the Bank must rectify its mistake of declaring the petitioner's

account as NPA. Having received no response, the petitioner has approached this Court through the present writ petition.

3. Written statement has been filed on behalf of the respondent Bank wherein it has been inter alia stated that as per the Circle Statutory Auditor, the account was declared NPA w.e.f 31.3.2018 on account of substantial other income (other than the activity financed i.e. manufacturing received by party in its balance sheet). As per the auditor's remarks, the company was incurring operating loss from its core activity for which it was financed. As such, it was observed that the company was misusing the working capital advance to earn interest which was not directly related to manufacturing activity of the Company. In the balance sheet, the company was showing net profit of ₹ 8.52 lacs whereas their other income was ₹ 48.33 lacs received as interest income. Despite the Bank asking for the agreements with farmers and traders for purchasing the wheat @ 12%, the supporting evidence was not produced. The Bank had no other option but to declare account as NPA. From the perusal of the balance sheet, sales and profitability for the last three years, it transpired that the income generated was from the interest component and the unit had been operating loss during the last three years and the bank was financing the loss which was pin pointed by the auditor. Further, it came to the notice of the bank that the petitioner had closed the manufacturing unit situated at Village Alladadpur, Amloh, Fatehgarh Sahib in the month of October 2007 without informing the Bank. The availed facility was not being used for the purpose it had been financed to it. On these premises, prayer for dismissal of the petition has been made.

4. Learned counsel for the petitioner submitted that as per provisions of the RBI guidelines, for an asset to be classified as a non

performing asset, there needs to be a default in principal amount or interest payment for the loan by the borrower. In the present case, no such default has occurred on behalf of the petitioner. Secondly, the action of the respondent bank in declaring the petitioner company as NPA is contrary to the principles of natural justice and *audi alteram partem* as the same was done by the respondent bank without giving any opportunity of being heard to the petitioner. There was no notice issued under Section 13(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (in short, “the SARFAESI Act”) before declaring the account of the petitioner as NPA. It was urged that it was not proper for the Bank to claim that once the account was declared as NPA, no opportunity was required to be provided to the borrower for regularization of the account. In other words, it was argued that once an account was declared to be NPA, the bank ought to have given an opportunity to the petitioner to remove any temporary deficiency.

5. On the other hand, learned counsel for the respondent Bank supported the impugned action by relying upon the provisions of SARFAESI Act and the Master Circular –Prudential norms on income recognition, Asset classification and provisioning pertaining to advances issued by the Reserve Bank of India.

6. We have heard learned counsel for the parties.

7. The vital questions that arise for consideration in this petition are:-

- i) When can the disbursing power be altered/reduced and whether principles of natural justice in the form of an opportunity are required to be provided to the borrower before doing so?

- ii) Whether cash credit limit or term loan once declared NPA, can it be restored as standard account?

Re: (i)

8. Before adjudicating the controversy involved in the present petition under Issue No.(i), it would be apposite to reproduce the relevant statutory provisions under the SARFAESI Act, which reads thus:-

SARFAESI ACT

Section 2.

“Definitions (1) In this Act, unless the context otherwise requires,--

(a) to (i) xxxxxxxx

(j) "default" means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor ;

(k) to (n) xxxxxxxxxxxx

(o) “non-performing asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset,-- (a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body; (b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank

Section 13. Enforcement of security interest:

- (1)** Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882 (4 of 1882), any security interest created in favour of any secured creditor may be enforced, without the intervention of court or

tribunal, by such creditor in accordance with the provisions of this Act.

- (2) Where any borrower, who is under a liability to a secured creditor under a security agreement, 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, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4).
- (3) The notice referred to in sub-section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.

Provided that –

- (i) The requirement of classification of secured debt as non-performing asset under this sub section shall not apply to a borrower who has raised funds through issue of debt securities; and
- (ii) In the event of default, the debenture trustee shall be entitled to enforce security interest in the same manner as provided under this section with such modifications as may be necessary and in accordance with the terms and conditions of security documents executed in favour of the debenture trustee.
- (3A) If, on receipt of the notice under sub-section (2), the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within one week of receipt of such representation or objection the reasons for non-

acceptance of the representation or objection to the borrower:

PROVIDED that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A.

(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:--

- (a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
- (b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset:

PROVIDED that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:

PROVIDED FURTHER that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt.

- (c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
- (d) require at any time by notice in writing, any person who has acquired any of the secured assets from the

borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

XXXXXXXXXXXXXXXXXX”

9. A plain reading of Section 2(1)(j) of the SARFAESI Act shows that ‘default’ means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor. “Non-performing asset” under Section 2(1)(o) of the SARFAESI Act means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset. Chapter III of the SARFAESI Act provides a complete mechanism for enforcement of Security interest by the secured creditor. Section 13 of the SARFAESI Act gives a detail procedure for the said purpose. Sub section (1) of Section 13 provides for enforcement of security interest credited in favour of the secured creditor without intervention of the Court or Tribunal in accordance with the provisions of the said Act. Sub section (2) of Section 13 of SARFAESI Act provides that where any borrower under a liability to a secured creditor under a security agreement makes any default in repayment of secured debt or any installment thereof and his account is classified as non-performing asset by the secured creditor, then the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within 60 days from the date of the notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub section (4) of Section 13 of the SARFAESI Act. A proviso has been inserted by Act No.44 of 2016 with

effect from 11.09.2016 to the effect that the requirement of classification of secured debt as non performing asset under this sub section shall not apply to a borrower who has raised funds through issue of debt securities and in the event of default, the debenture trustee shall be entitled to enforce security interest in the same manner as provided under this section with such modifications as may be necessary and in accordance with the terms and conditions of security documents executed in favour of the debenture trustee. Sub section (3) of Section 13 of the SARFAESI Act enumerates that the notice issued under sub section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor. Sub section (3A) of Section 13 of SARFAESI Act shows that on receipt of notice under sub-section (2) of Section 13 of the SARFAESI Act, the borrower is entitled to make any representation or raise any objection to the secured creditor. On receipt of such representation/objection, the same shall be decided by the secured creditor and reasons for non acceptance thereof shall be conveyed to the borrower. The proviso to Section 13(3A) of the SARFAESI Act stipulates that the reasons for communication or the likely action of the secured creditor shall not confer any right upon the borrower to prefer an application before the DRT under Section 17 of the SARFAESI Act or the Court of District Judge under Section 17A of the SARFAESI Act. It is after the non-acceptance of the representation/objections under section 13(3A) of the SARFAESI Act, the action is taken by the secured creditor under Section 13(4) thereof to recover his secured debt which includes taking possessing of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset and then a right accrues to the borrower aggrieved by any of the measures under section

13(4) of the SARFAESI Act to take recourse to the remedies under Section 17 of the Act.

10. The disbursing power sanctioned to a borrower is the limit upto which the borrower can utilize the facility of the sanctioned loan. It is generally sanctioned on the basis of the value of the hypothecated stock and book debts which are taken as tangible secured asset. The borrower is obligated under the disbursing power to maintain minimum level of stocks and book debts to safeguard the financial interest of the financial/banking institution. It is required to submit its stock statements and other relevant information periodically and regularly for the verification of the lender. Any default on the part of the borrower to adhere to these norms entitles the creditor to alter/reduce the disbursing power. The question is whether before altering or reducing the disbursing power given to the borrower by the Bank, notice is required to be given or not. In our opinion, due opportunity of hearing and explaining the factual position alongwith documentary proof is required to be given to the borrower to support his claim. The decision is based on the principle enunciated in *audi alterm partem*. The principles of natural justice are required to be followed when a quasi judicial body engages in determining disputes between the parties or administrative action is taken which involves civil consequences. The Apex Court in **Canara Bank v. V.K. Awasthy**, AIR 2005 SC 2090 while dealing with the doctrine of principles of natural justice had noticed as under:-

“9. Natural justice is another name for common sense justice. Rules of natural justice are not codified canons. But they are principles ingrained into the conscience of man. Natural justice is the administration of justice in a common sense liberal way. Justice is based substantially on natural ideals and human values. The administration of justice is to be freed from the narrow and

restricted considerations which are usually associated with a formulated law involving linguistic technicalities and grammatical niceties. It is the substance of justice which has to determine its form.

10. The expressions "natural justice" and "legal justice" do not present a water-tight classification. It is the substance of justice which is to be secured by both, and whenever legal justice fails to achieve this solemn purpose, natural justice is called in aid of legal justice. Natural justice relieves legal justice from unnecessary technicality, grammatical pedantry or logical prevarication. It supplies the omissions of a formulated law. As Lord Buckmaster said, no form or procedure should ever be permitted to exclude the presentation of a litigants' defence.
11. The adherence to principles of natural justice as recognized by all civilized States is of supreme importance when a quasi-judicial body embarks on determining disputes between the parties, or any administrative action involving civil consequences is in issue. These principles are well settled. The first and foremost principle is what is commonly known as audi alteram partem rule. It says that no one should be condemned unheard. Notice is the first limb of this principle. It must be precise and unambiguous. It should appraise the party determinatively the case he has to meet. Time given for the purpose should be adequate so as to enable him to make his representation. In the absence of a notice of the kind and such reasonable opportunity, the order passed becomes wholly vitiated. Thus, it is but essential that a party should be put on notice of the case before any adverse order is passed against him. This is one of the most important principles of natural justice. It is after all an approved rule of fair play. The concept has gained significance and shades with time. When the historic document was made at Runnymede in 1215, the first statutory recognition of this principle found its way into the "Magna Carta". The classic exposition of Sir Edward Coke of natural justice requires to "vocate interrogate and adjudicate". In the celebrated case of *Cooper v. Wandsworth Board of Works*, (1963) 143 ER 414, the principle was thus stated:

"Even God did not pass a sentence upon Adam, before he was called upon to make his defence. "Adam" says God, "where art thou has thou not eaten of the tree whereof I commanded thee that though should not eat".

12. Since then the principle has been chiselled, honed and refined, enriching its content. Judicial treatment has added light and luminosity to the concept, like polishing of a diamond.

13. Principles of natural justice are those rules which have been laid down by the Courts as being the minimum protection of the rights of the individual against the arbitrary procedure that may be adopted by a judicial, quasi-judicial and administrative authority while making an order affecting those rights. These rules are intended to prevent such authority from doing injustice."

11. Further, sub-section (2) of Section 13 of the SARFAESI Act provides for giving a notice by the secured creditor to the borrower in writing to discharge his liability to the secured creditor within 60 days from the date of notice failing which the provision has been made for entitling the secured creditor to exercise all or any of the rights under sub section (4) of Section 13 of the SARFAESI Act. In ***Mardia Chemicals Limited and others vs. Union of India and others***, (2004) 4 SCC 311, the Supreme Court clearly emphasized the need of serving a notice upon the borrower under sub-section (2) of Section 13 of the SARFAESI Act so that an opportunity is provided to the borrower for explaining the reasons within sixty days for not initiating action under sub-section (4) of Section 13 of the SARFAESI Act. It was observed that the objective of the issuance of notice under Section 13(2) of the SARFAESI Act and providing an opportunity to the borrower was to ensure that there was fair consideration of some meaningful objection raised by the borrower, if any, before affecting his rights. It was recorded that once such a duty was envisaged on the part of the creditor, it would only be conducive to the principles of fairness on the part of the banks and financial

institutions in dealing with their borrowers. The Supreme Court also recorded that it will only be on fulfillment of a requirement of reasonableness and fairness in the dealings of institutional financing which is so important from the point of view of the economy of the country and would also serve the purpose in the growth of a healthy economy. Besides, it would certainly provide guidance to the debtors so that they may conduct their affairs in future in a manner to avoid recurrence of any such default resulting in unsavoury steps by the creditors.

12. Elaborating the need for providing opportunity of hearing before classification of an account as Non-Performing Asset, the Jharkhand High Court in *Stan Commodity Pvt. Limited through its Managing Director, Pawan Kumar Poddar vs. Punjab and Sind Bank through its Chairman and others*, AIR 2009 Jharkhand 14 had laid down as under:-

“28. In view of the provisions of the guidelines of the RBI, the petitioner was entitled to be informed and any doubt or dispute was to be settled between the creditor and the borrower through any specific internal channel within one month from the date on which the account would have been classified as NPA. Even if there was no internal channel to settle such dispute/doubt, the petitioner was entitled to be informed and to get an opportunity to explain or represent against the intended classification of his account as NPA.

29. The provision of the guidelines providing for some specific internal channel for settling the doubt in asset classification is akin to the requirement of the principles of natural justice, which according to the Supreme Court in **Smt. Maneka Gandhi v. Union of India and Anr. : [1978]2 SCR 621** must be read and followed even if the provision is silent to that regard. The respondent being a Public Sector Bank are expected to follow the just, fair / prescribed procedure to meet the requirement of law and Article 14 of the [Constitution of India](#).”

13. From the above, it is concluded that in view of the principles of equity and natural justice, an opportunity is required to be provided to the borrower before the creditor modifies or reduces the disbursing power.

Re: (ii)

14. We now proceed to notice the legal position with respect to issue No.(ii). Section 35A of Banking Regulations Act, 1949 (in short, “the 1949 Act”) was inserted by the Banking Companies (Amendment) Act, 1956 which empowers the Reserve Bank of India to issue directions inter alia in the interest of banking policy, which is in the following terms:-

“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.”

According to sub section (1) of Section 35A of 1949 Act, the Reserve Bank is authorized to issue directions to the Banking companies generally or to any

banking company in particular wherever it is satisfied that it is in the public interest or in the interest of banking policy or to prevent the affairs of any banking company being conducted in a manner detrimental to the interest of the depositors or in a manner prejudicial to interests of the banking company or to secure the management of any banking company generally. However, under sub section (2), the Reserve Bank may modify or cancel any such direction issued under sub section (1) on a representation made to it or on its own motion and it may impose such condition as it thinks fit in doing so.

15. The 1949 Act also provides for power of the Reserve Bank of India to control advances by banking companies in terms of Section 21 thereof which reads thus:-

"21 - Power of Reserve Bank to control advances by banking companies

(1) Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest or in the interests of 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 banking company in particular, and when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.

(2) Without prejudice to the generality of the power vested in the Reserve Bank under sub- section (1) the Reserve Bank may give directions to banking companies, either generally or to any banking company or group of banking companies in particular, as to-

(a) the purposes for which advances may or may not be made,

- (b) the margins to be maintained in respect of secured advances,
- (c) the maximum amount of advances or other financial accommodation which, having regard to the paid-up capital, reserves and deposits of a banking company and other relevant considerations, may be made by that banking company to any one company, firm, association of persons or individual,
- (d) the maximum amount up to which, having regard to the considerations referred to in clause
- (c) ,guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual, and
- (e) the rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.

(3) Every banking company shall be bound to comply with any directions given to it under this section."

A plain reading of the aforesaid provision would clearly show that the Reserve Bank of India is entitled to formulate the policies which the Banking Companies are bound to follow.

16. The Constitution Bench in ***Central Bank of India vs. Ravindra and others***, (2002) (1) SCC 367 held the guidelines issued by the Reserve Bank of India in exercise of powers under Sections 21 and 35A of the 1949 Act to be binding in the following terms:-

"55... (5) The power conferred by [Sections 21](#) and [35-A](#) of the Banking Regulation Act, 1949 is coupled with duty to act. The Reserve Bank of India is the prime banking institution of the country entrusted with a supervisory role over banking and conferred with the authority of issuing binding directions, having statutory force, in the interest of the public in general

and preventing banking affairs from deterioration and prejudice as also to secure the proper management of any banking company generally. The Reserve Bank of India is one of the watchdogs of finance and economy of the nation. It is, and it ought to be, aware of all relevant factors, including credit conditions as prevailing, which would invite its policy decisions. RBI has been issuing directions/circulars from time to time which, inter alia, deal with the rate of interest which can be charged and the periods at the end of which rests can be struck down, interest calculated thereon and charged and capitalised. It should continue to issue such directives. Its circulars shall bind those who fall within the net of such directives. For such transaction which are not squarely governed by such circulars, the RBI directives may be treated as standards for the purpose of deciding whether the interest charged is excessive, usurious or opposed to public policy."

17. The Supreme Court in *M/s Sardar Associates and others vs. Punjab and Sind Bank and others*, 2009 (8) SCC 257 while examining the nature of supervisory power of Reserve Bank of India in the matter of functioning of Scheduled Banks concluded that a distinction must be made between statutory and non-statutory guidelines. Further, the mandate of Banking Policy and directions issued by Reserve Bank of India in public interest or in the interest of the depositors are required to be followed by the Banking company. In other words, they are equally bound to comply with all the guidelines issued by the Reserve Bank of India.

18. The Master Circular – Prudential Norms on Income Recognition, Asset, Classification and provisioning pertaining to Advances dated 01.07.2015 has been issued by the Reserve Bank of India in exercise of its powers under Sections 21 and 35A of the Banking Regulation Act, 1949 to all commercial banks which provides for the manner in which a loan account

is to be declared NPA, recovery and the management of the loan accounts. A reading of the aforesaid Master Circular makes it amply clear that every NPA would fall either in the category of sub-standard or doubtful or loss asset. Certain clauses of the said Master circular issued by the Reserve Bank of India are extracted hereunder:-

“Master Circular – Prudential Norms on income recognition, Asset classification and provisioning pertaining to Advances.”

2.1 Non performing Assets

2.1.1 An asset, including a leased asset, becomes non performing when it ceases to generate income for the bank.

2.1.2 A non performing asset (NPA) is a loan or an advance where;

- i. interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,
- ii. the account remains ‘out of order’ as indicated at paragraph 2.2 below, in respect of an Overdraft/Cash Credit (OD/CC),
- iii. the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- iv. the installment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
- v. the installment of principal or interest thereon remains overdue for one crop season for long duration crops,
- vi. the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction undertaken in terms of guidelines on securitization dated February 1, 2006.
- vii. in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

- 2.1.3** In case of interest payments, banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.
- 2.1.4** In addition, an account may also be classified as NPA in terms of paragraph 4.2.4 of this Master Circular.

2.2 'Out of Order' status

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power for 90 days. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

4. ASSET CLASSIFICATION

4.1 Categories of NPAs

Banks are required to classify non performing assets further into the following three categories based on the period for which the asset has remained non performing and the realisability of the dues:

- Substandard Assets
- Doubtful Assets
- Loss Assets

4.1.1 Substandard Assets

With effect from March 31, 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are

characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

4.1.2 Doubtful Assets

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.

4.1.3 Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

4.2 Guidelines for classification of assets

4.2.1 Broadly speaking, classification of assets into above categories should be done taking into account the degree of well-defined credit weaknesses and the extent of dependence on collateral security for realisation of dues.

4.2.2 Banks should establish appropriate internal systems (including technology enabled processes) for proper and timely identification of NPAs, especially in respect of high value accounts. The banks may fix a minimum cut off point to decide what would constitute a high value account depending upon their respective business levels. The cutoff point should be valid for the entire accounting year. Responsibility and validation levels for ensuring proper asset classification may be fixed by the banks. The system should ensure that doubts in

asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extant guidelines.

4.2.3 Availability of security / net worth of borrower/ guarantor

The availability of security or net worth of borrower/ guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise, except to the extent provided in Para 4.2.9.

4.2.4 Accounts with temporary deficiencies

The classification of an asset as NPA should be based on the record of recovery. Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines:

- i) Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular.

A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.

- ii) Regular and ad hoc credit limits need to be reviewed/regularised not later than three months from the due date/date of ad hoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/date of ad hoc sanction will be treated as NPA.

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.

4.2.6 Accounts regularised near about the balance sheet date

The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account

should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors/Inspecting Officers about the manner of regularization of the account to eliminate doubts on their performing status.

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4.2.9 Accounts where there is erosion in the value of security/frauds committed by borrowers

- i. In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment, the asset should be straightaway classified as doubtful or loss asset as appropriate:
- b. Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category.
- c. If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset.

ii) Provisioning norms in respect of all cases of fraud:

- a. The entire amount due to the bank (irrespective of the quantum of security held against such assets), or for which the bank is liable (including in case of

deposit accounts), is to be provided for over a period not exceeding four quarters commencing with the quarter in which the fraud has been detected;

- b. However, where there has been delay, beyond the prescribed period, in reporting the fraud to the Reserve Bank, the entire provisioning is required to be made at once. In addition, Reserve Bank of India may also initiate appropriate supervisory action where there has been a delay by the bank in reporting a fraud, or provisioning there against.

19. Clause 2.1 of RBI guidelines Master Circular deals with Non-Performing Assets and it inter alia provides that an asset including a leased asset becomes non performing when it ceases to generate income for the Bank. A non performing asset is a loan or an advance where interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a term loan or the account remains out of order in respect of an overdraft/cash credit. As per clause 2.2, an account should be treated as “out of order” if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power for 90 days. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power but there are no credits continuously for 90 days as on the date of balance sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as out of order. As per clause 4.1 under the heading “asset classification”, it has been provided that the banks are required to classify non performing assets into further three categories i.e. substandard assets, doubtful assets and loss assets. With effect from March 31, 2005, a substandard asset would be one which has remained

NPA for a period less than or equal to 12 months. An asset would be

classified as “doubtful” if it has remained in the substandard category for a period of 12 months. A “loss asset” is one where loss has been identified by the Bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. Clause 4.2.1 provides that classification of assets into the above categories should be done taking into account the degree of well defined credit weaknesses and the extent of dependence on collateral security for realization of dues. Clause 4.2.4 provides that the bank should not classify an advance account as NPA merely due to the existence of some deficiencies which were temporary in nature such as non availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non submission of stock statements and non renewal of the limits on the due date etc. Further, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. Clause 4.2.5 provides for 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 not longer be treated as non performing and may be classified as standard accounts. As per clause 4.2.6, the asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the Banks must furnish satisfactory evidence to the statutory auditors/inspecting officers about the manner of regularization of the account to eliminate doubts on their performing status. Clause 4.2.9 prescribes that in respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non availability of

security and existence of other factors such as frauds committed by borrowers, it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment, the asset should be straightaway classified as doubtful or loss asset as appropriate. Erosion in the value of security can be reckoned as significant when the realizable value of the security is less than 50 percent of the value assessed by the Bank or accepted by RBI at the time of last inspection as the case may be. Such NPAs may be straightaway classified under doubtful category.

20. From the aforesaid, it clearly emerges that the decision of the Bank before classifying an asset as NPA should be based on the record of recovery. An account which has some temporary deficiencies like non-availability of adequate disbursing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of limits on the due date etc., should not be classified as NPA. Further, the Reserve Bank of India in its Master Circular dated 01.07.2015 in Clause 4.2.4 thereof enumerated various guidelines which the Bank must follow for the removal of the temporary deficiencies. Clause 4.2.5 of the said Master Circular mandates that where the arrears of interest and principal are cleared by the borrower in the case of loan accounts classified as NPAs, the accounts should not be any longer treated as non-performing and may be classified as 'Standard' account. Thus, in nutshell, it is concluded that where the borrower expresses willingness for regularizing the loan account by discharging the arrears of interest and principal, the Bank/financial institutions are obligated to accept the same as per mandate expressed in the Master Circular dated 01.07.2015 issued by the

Reserve Bank of India in exercise of powers under the 1949 Act and declare the account to be 'Standard' account.

21. In *Sravan Dall Mill P.Limited vs. Central Bank of India*, AIR 2010 AP 35, the Andhra Pradesh High Court was considering Clause 4.2.4 of the RBI guidelines which were prevalent then which are akin to Clause 4.2.5 of the RBI Master Circular dated 01.07.2015, had held that the classification of Account as NPA must be in accordance with the directions or guidelines relating to assets classification issued by RBI. Further, it was categorically recorded that it is incorrect to presume that once an NPA is always an NPA. It was noticed that clause 4.2.4 of Prudential Norms specifically provides that if the interest and principal are paid by the borrower in the case of loans classified as NPA, said account should no longer be treated as NPA. The relevant para of the judgment reads thus:-

“23. The right of the borrower to have a due consideration of objections is, therefore an important right of the borrower where the bank is bound to apply its mind and inform the borrower of its reasons as to why and how the account is classified as NPA, particularly, when the borrower raises specific objections in that regard. The reply of the bank must indicate application of mind by the bank that the decision of the Bank in classifying the account as NPA was fully in conformity with the prudential norms of RBI. Non consideration of the said objection by mere statements in the reply that the bank has considered the same cannot be said to be the fulfillment of the obligation of the bank under section 13(2) and 13(3)(A) of the SARFAESI Act. It also cannot be disputed that even assuming that particular 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 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.”

22. Clause 4.2.5 of the Master circular dated 01.07.2015 came up for consideration before Division Bench of this Court in *M/s Oswal Spinning & Weaving Mills Limited vs. Reserve Bank of India and others*, 2016(3) PLR 590 wherein similar issue had come up for discussion before the Court. Considering the decision of the Andhra Pradesh High Court in *Sravan Dall Mill P. Limited's* case (supra), it was held as under:-

“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.”

23. Having analysed and crystallized the legal position as noticed hereinabove, we advert to the factual matrix in the present case. In our opinion, the action of the respondent is legally unsustainable. Undisputedly, the petitioner had availed cash credit facilities from the respondent Bank since 2007 against the company stock statements and book debts. Collateral security was given in terms of factory, land and building by the petitioner to fully secure the cash credit facility. The Bank was renewing the contract yearly. Suddenly on 27.6.2018, the Bank informed the petitioner that its account had been declared NPA by the statutory auditor and was directed to deposit the entire outstanding amount in the account. The reasons given by the Bank were that the company was incurring loss from its core activity for which the Bank had financed; the petitioner company was misusing the capital advanced to earn interests which was not directly related to the manufacturing activity of the company. The petitioner was not afforded any opportunity before reducing the disbursing power and declaring the account

as NPA. Further, as per clauses 4.2.4 and 4.2.5 of the Master Circular dated 01.07.2015 issued by the RBI, the petitioner could remove the temporary deficiencies in the maintenance of account as standard and to upgrade the account so as to be out of NPA.

24. In view of the above statutory provisions, factual matrix in the present case coupled with the settled legal position on the issue, the irresistible conclusion is that notice was required to be issued to the petitioner under the provisions of the SARFAESI Act by the Bank before declaring its account as NPA. Accordingly, the impugned letter/email dated 27.6.2018, Annexure P.8 and all consequential action taken on that basis are set aside and the matter is remanded to the respondents to take a decision afresh in accordance with the guidelines issued by the Reserve Bank of India termed as RBI's prudential norms of income recognition, asset, classification and provisioning pertaining to advances after affording an opportunity to the petitioner. Consequently, the writ petition stands allowed.

(Ajay Kumar Mittal)
Judge

May 17, 2019
'gs'

(Manjari Nehru Kaul)
Judge

Whether speaking/reasoned
Whether reportable

Yes
Yes