

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved on: 21.08.2020

Pronounced on:
25.08.2020

CORAM:

THE HONOURABLE DR. JUSTICE G.JAYACHANDRAN

Second Appeal No.587 of 2010

and

M.P.No.1 of 2010

1.The Deputy General Manager,
Small Industries Development Bank of India,
Gowtham Centre, 1055/7,
Avinashi Road, Coimbatore 641 018.
Coimbatore 18.

2.Small Industries Development Bank of India,
Coimbatore,
Rep.by its Deputy General Manager,
Gowtham Centre, 1055/7,
Avinashi Road, Coimbatore 641 018.
Coimbatore-18.

.. Appellants/Defendants 1, 2

/versus/

M/s Annamalai Hotels (Pvt.)Ltd.,
Rep.by its Managing Director,
Mr.P.Velusamy,
8/25, State Bank Road,
Coimbatore 641 018.

.. Respondent /Plaintiff

Prayer: Second Appeal has been filed under Section 100 of C.P.C., praying to set aside the decree and judgment in A.S.No.2 of 2007 dated 23.10.2009 passed by the First Additional District Judge of Coimbatore partly reversing the judgment and decree dated 15.09.2005 passed in O.S.No.685 of 2002 on the file of Second Additional Sub Judge of Coimbatore.

For Appellant : Mrs.Rajalakshmi for
Mr.Shivakumar

For Respondent :Mr.Mukunth for
M/s Sarvabhuman Asso.

J U D G M E N T

(The case has been heard through video conference)

Small Industries Development Bank of India (in short "SIDBI") is a financial institution under the supervision of Reserve Bank of India. Its object is to provide financial assistance to the Small Scale Sectors. M/s Annamalai Hotels

(P) Ltd, sought Rs.160 lakhs term loan from SIDBI for their hotel project and paid 1% upfront fee. In principle, loan was sanctioned, but before the disbursement of the loan, the sanction was withdrawn by SIDBI. The suit for return of upfront fee filed by M/s Annamalai Hotels was decreed by the Trial Court and the same was confirmed by the first Appellate Court. Against the concurrent finding, the present Second Appeal is filed by SIDBI.

2. For sake of convenience, the appellant/defendant the SIDBI (hereinafter be referred as "Bank") and the respondent/plaintiff M/s Annamalai Hotel (P) Ltd (hereinafter be referred as "Applicant").

3. On 18/01/1998, M/s Annamalai Hotels (Pvt.) Ltd.. applied to the Deputy Manager of SIDBI at Coimbatore to extend term loan of Rs.160 lakhs to meet the part cost of its project of construction of a new hotel complex at Coimbatore. After discussions with the Applicant, on 05/04/1999, the application for financial assistance under project financial scheme was positively considered by SIDBI and informed the Applicant that SIDBI is agreeable, in principle, to grant term loan not exceeding Rs.160 lakhs to meet the project for setting up the hotel complex at the estimated cost of Rs.310 lakhs. In the letter dated 05/04/1999, the applicant was asked to furnish within 30 days the Board of Director resolution agreeable to enter into a Loan Agreement with SIDBI. The Applicant was also asked to provide a statement of anticipated drawals of loans including probable dates(s) and amounts of drawal(s). To this letter, Annexure I carried the special terms and condition. Under Clause 3 of the Annexure I, the Applicant shall pay to SIDBI non - refundable upfront fee of 1% of the sanctioned loan amount at the time of issue of Letter of Intent. Annexure II, the Normal terms and conditions for grant of financial assistance and Annexure III, the proforma for the Board Resolution.

4. As per Clause 3 In annexure I- Special terms and conditions upfront fee of 1% (Rs.1.60 lakhs) of the sanctioned loan amount (Rs.160 lakhs) was paid by the Applicant, on 05/04/1999, through a demand draft and the same was encashed by the Bank. On 10/04/1999 Board resolution was passed authorizing its Director V.Sampath Kumar to sign on behalf of the applicant. However, the Loan Agreement between the parties was not formally entered and the loan amount was not disbursed. Nearly after one year, in response to the Applicant query, the bank on 27/04/2000 informed the Applicant that the subsequent to issue of the letter of intent dated 05/04/1999, it came to their notice certain vital information having direct bearing on the creditworthiness of the company promoters/directors. Information relating to an associate/sister concern had not been disclosed by the company while applying for the term loan

or during the discussions. Therefore, they are constrained to cancel the term loan sanctioned vide, letter of intent dated 05/04/1999.

5. In the above circumstance, the applicant has filed the suit against the Bank for refund of Rs1,60,000/- being the principal. Rs.57,600/- towards interest at the rate of 12% and Rs.9000/- towards Engineer fees paid to get the project report.

6. The Bank resisted the suit, on the ground that the suit is bad for misjoinder of party. The upfront fee collected is non refundable. It is a pre-requisite for sanctioning the loan and paid pursuant to the terms of contract after arriving at a consensus- ad -Idem. After issuance of the letter of intent dated 05/04/1999, the Bank came to know that M/s TVS Bricks a sister concern of the Applicant had a over due of Rupees One Lakh in City Union Bank since January 1997. The overdue was cleared on 18/05/1999 (i.e two days prior to obtaining the statement of accounts furnished to SIDBI for availing the term loan of Rs.160 lakhs). The Applicant wantonly and willfully suppressed the vital fact during the preliminary discussion prior to issuance of letter of intent. This shows the un-creditworthiness of the applicant company and its promoters. If this vital information was made known during the preliminary discussion, the Bank would not have issued in principle sanction of term loan.

7. The trial Court framed the following issues:-

1. Whether the suit is not maintainable for misjoinder of first defendant?

2. Whether the plaintiff is entitled for refund of Rs.1,60,000-00?

3. Whether the 2nd defendant denied loan for breach of terms and conditions and for suppression of facts?

4. Whether the plaintiff is entitled for recovery of money as prayed for?

5. What relief?

8. The trial Court after analysing the sequence of events, held that immediately after receipt of the letter of intent, the upfront fee was paid by the applicant on 05/04/1999. The contract will get completed only on executing the loan agreement. Even before execution of loan agreement mentioned in the letter of intent and disbursement of the loan, the bank has withdrawn its intent to grant loan. The bank should have tested the creditworthiness of the applicant before issuance of the letter of intent. Hence, the Bank is liable to return the

upfront fee Rs.1.60 lakhs and Rs.9000/- the expense incurred for obtaining the project report with 12% interest.

9. In the first appeal preferred by the bank, the first appellate court substantially concurred with the trial court.

It confirmed the judgment and decree of the trial court with modification by dismissing the claim in respect of Rs.9000/- paid as Engineer fees to get the report. Also the rate of interest to the principal was reduced from 12% to 7.5% from the date of remittance to the date of suit and thereafter at the rate of 6% pa.

10. The learned counsel for the appellant bank submitted that the courts below failed to consider the fact that the upfront fee is collected for the purpose of processing the loan application and paid as per the agreed terms of contract. Therefore the plaintiff is estopped from seeking refund of it. There is no legal obligation on the part of the bank to prove the expenses incurred for processing. Non refundable upfront fee cannot become refundable because it was paid prior to execution of the loan agreement. The special terms and condition of the letter of intent will override the general terms and condition contained in the draft agreement. The learned counsel for the appellant circulated the following judgments to persuade the court to reverse the finding of the Courts below.

1. CDJ 2006 Cal HC 569: Delta Fabrics (Pvt) Ltd -vs- Industrial Development Bank of India.

2. M/s Debonair Fashions Pvt Ltd and others - vs- Union of India dated 08.07.2019

3. CDJ 2020 SC 296: Bank of India -vs- Brindavan Agro Industries(Pvt) Ltd.

11. Per contra, the learned counsel for the respondent/plaintiff submitted that, the Loan application was made during the month of December 1998. (Ex.B-1, dated 04/12/1998) The letter of intent was issued on 05/04/1999. (Ex.A-1 = Ex. B-3). The statement of the City Union Bank indicating there is no due with them is dated 18/05/1999. (Ex.B-12). The bank took more than a year to cancel the letter of intent quoting adverse information about the creditworthiness. The outstanding loan of Rs.one lakh in the City Union Bank by one of the promoter was cleared immediately after the bank informed about their 'in principle sanction' of term loan. There was no suppression of fact as contented by the Bank. The upfront fee is payable only on execution of loan agreement. Unless the loan agreement is executed, the loan will not be sanctioned. In this case only letter of intent was issued. The loan agreement was not entered between the bank and the Applicant. However in

advance, the upfront fee was paid in anticipation. Once the bank decided not to sanction loan, the upfront fee of Rs.1,60,000/- is bound to be returned. The bank cannot enrich themselves unjust. Had the upfront money paid after sanction of loan, it will become non-refundable. If loan is not sanctioned, there is no quid pro-quo for the upfront fee paid. Therefore it has to be refunded.

12. Heard the rival submissions placed by the learned counsels on either side.

13. The letter of indent dated 05/04/1999 disclose the following facts and events:-

18/12/1998: Application for term loan by M/s Annamalai Hotels (Pvt) Ltd to SIDCO.

05/04/1999: Letter of Intent by SIDCO intimating they are agreeable in principle to grant loan not exceeding Rs.160 lakhs, subject to:

a) the General Conditions GC -5-94 deemed to be part of the letter of intent and the special terms and conditions set out in Appendix- I.

b) The applicant shall enter into a Loan Agreement with SIDBI (as per the specimen form of Loan agreement in Appendix II).

c) The certificate copy of the Applicant Company Board Resolution to the effect, the applicant is agreeable to enter into the loan agreement within the time stipulated by SIDBI and till such agreement is executed there is no obligation or commitment on the part of SIDBI to advance any money. (emphasis added).

14. In Appendix -I of Ex A-1, clause 3 reads as under: Upfront fee: The company shall pay to SIDBI non-refundable upfront fee of 1% of the sanctioned loan amount at the time of issue of Letter of Intent.

15. Soon after the receipt of the letter of intent Ex A-1, the applicant has paid Rs.1,60,000/- the 1% of the sanctioned loan amount. But, the parties did not enter into the loan agreement as per the specimen form given in Appendix II. It is contended by the learned counsel for the appellant that the Bank collected the upfront fee for processing the loan application and they have incurred expenses for processing the application. In the given facts of the case, such a plea is not sustainable. The upfront fee was demanded only after processing the application and on being satisfied in principle to grant loan. Fees from the Applicant was not collected for processing. The purpose of collecting processing fee is entirely different from the purpose of collecting upfront fee.

16. In Delta Fabrics (Pvt) Ltd -vs-Industrial Development Bank of India case cited supra, relied by the Bank, the upfront

fee was collected and thereafter parties negotiated terms of the agreement. The customer did not agree with the terms prescribed by the bank. The bank ultimately cancelled the sanction. The customer accepted the cancellation, however, asked for refund of upfront fee which was refused by the bank. Writ petition filed by the customer before the High Court, Calcutta. The learned Single Judge dismissed the writ petition holding that, the fee collected was for processing the loan application, which the bank is entitled to collect. Whether such fees was on higher side or can not be examined under writ jurisdiction. On appeal, The Division Bench of the Calcutta High Court dismissed the appeal and held that,

"(12).....The writ petitioner prayed for accommodation of Rs.1210.00 lacs. The appellant bank, however, granted them sanction of Rs.650.00 lacs. At that juncture the Bank asked the writ petitioner to pay the upfront fee. There was no stipulation made by the petitioner for refund of the said fee. The petitioner also understood such demand as legally payable by them and as such they paid the same. In this regard, Mr.Panja drew our attention to Clause 1(iii) of the draft agreement by which it was stipulated that the company would be liable to pay upfront fee at the time of issue of letter of intent. Drawing out attention to such clause, Mr.Panja contended that such clause was to be incorporated in the agreement which was never entered into. Hence, such clause could not be enforced. Mr.Panja's argument in our view on this score could have been well-founded had it been made at the stage when such demand was raised. The petitioner understood the demand of the Bank as a precondition to get the sanction. Accordingly, they paid the amount. On the ground that the agreement was not entered into the petitioner was not entitled to claim for refund specially when the bank was ready and willing to grant the loan by making a promise through its letter of intent by sanctioning the loan. (emphasis added)

(13)The problem could be viewed from another angle. The dictionary meaning of the word "fee" is "charge" in terms of money against the service rendered". From such meaning it is clear that unless it is paid in advance question of refund would not come. In the instant case, the money was paid not along with the application made for sanction.

It was paid at a later stage when the Bank came to a final decision that they would grant loan and accordingly sanctioned the same and issued the letter of intent to that extent. Hence, there could be no question of refund of such fee."

17. In M/s Deonair Fashions Pvt Ltd and another -vs- Union of India and others, relied by the Bank, the writ petitioner approached the bank for credit facility. Despite the sanction granted, due to suppression of material facts, the bank did not disburse the loan amount. Petition filed for refund of the processing fees Rs.8.20 lakhs. The petition was dismissed by the court on the ground that, the sanction letter contain a condition that, the Bank is entitled to processing fee. The bank is justified in not disbursing the loan since the petitioner suppressed the proceedings against them under the SARFAESI Act. Hence the question of refund the processing fee does not arise.

18. In Bank of India -vs- Brindavan Agro Industries Pvt Ltd., CDJ 2020 SC 296, case, based on the loan application dated 15/10/2011 submitted by the customer, the Bank handed over the papers to the Credit Processing Unit (CPU) for valuation /search report of the properties to be mortgaged and Techno Economic Viability (TEV) study. Meanwhile, on 4/11/2011 the customer revised its credit required seeking additional credit facilities. The revised request was also forwarded for TEV study. Soon thereafter on 17/12/2011, the customer again revised its credit requirement reducing the LC from Rs.25 crores to Rs.19 crores. On 30/12/2011 the bank debited a sum of Rs.27,41,161/- from the account of the customer being 50% of the applicable processing fees including TEV study and service tax charges. The customer objected to the deduction of processing fee as the bank could only do so after the loan was sanctioned. It sought for refund of the said amount on the ground of suffering losses, owing to the alleging delay of the bank in sanctioning the credit facilities. However, the Bank sanctioned the loan on 17/03/2012. In the interregnum period, the customer approached two other banks and got loan sanctioned.

19. For refund of the process fees deducted from the account, the customer approached the State Consumer Dispute Redressal Commission (SCDRC). The State Commissioner allowed the application directing the Bank to refund Rs.27,41,161/- with 9 % interest. The National Commission confirmed the award of the State commission with few modification. On appeal to the Supreme Court, after analyzing the Bank's circular dated 20/04/2005 regarding the procedure for sanction of loan held that, the consumer is not entitled for refund of processing fees, but relying upon the Bank circular regarding 60% refund of TEV charges in case of non sanction of limits by the bank and the bank agreement to refund Rs.9.16 lakhs, directed the Bank to refund the amount agreed.

20. In all the above judgments, the Banks have placed before the court that money was collected for processing the loan application and also positively demonstrated to the court that they have spent on processing the application. Processing by engaging experts to study about viability or investigate the credit worthiness of the customer. Whereas, in the instant case, there is no evidence to show that the bank collected the money as processing fee or after receipt of the upfront fee incurred any expenses for processing. Further, the reason for refusing to advance loan also had come out belatedly after a year from collecting the upfront fee and the reason could not seem to the real reason for withdrawal of intent.

21. According to the Bank, in its written statement it is averred that, the upfront fee is charged since the second defendant has to incur expenses for its officers/staff for appraisal/studying the project, to verify the applicant/documents submitted for availing for loan. Further it is contended that, the upfront fee paid is not for making disbursement of the term loan but it is only for enabling the second defendant to issue letter of intent and other further activities related thereto. Whereas we find, the upfront fee is demanded only after issuance of the letter of intent on 05/04/1999. The applicant has submitted letter from City Union Bank that M/s TVS Bricks have no dues with it. The letter is dated 18/05/1999. The Bank in the written statement had contended that, a sum of ? one lakh was due with City Union Bank from 1997, it was cleared only 2 days prior to the statement. Though the amount was only Rs.one lakh, yet it shows the creditworthiness of the company and its promoter.

22. The judgments cited by the appellant counsel is of no assistance to their case since in the instant case, the fee was collected specifically under the head 'Upfront fee' and not under 'processing fee'. The fee was not collected along with application for loan but after issuance of letter of intent. Even if the fee was used for processing as now contended by the bank, nothing placed before the trial court to substantiate the said plea. Furthermore, if they had good reason to withdraw the letter of intent, it should have been expressed to the applicant at the earliest point of time and not after one year that too as a response to the query from the Applicant.

23. In a financial contract, the banker cannot be compelled to advance loan to a person whose creditworthiness is not inspiring. It is the prerogative of the bank to choose its customer. However, when a fee is collected on the promise that they are satisfied with the project and in principle agree to advance loan, then refuse to advance loan, keeping the customer guessing for more than a year cannot be in tune with the general principle of contract law or to the special terms and condition. It amounts to breach of promise and unjust enrichment.

24. The Division Bench of the Andhra Pradesh High Court in Punjab National Bank, Rep. by its Chief Manager Large Corporate Branch -Versus- Gangavaram Port Limited, Rep. by its Authorized Signatory, Manager - Administration reported in 2017 CDJ APHC 398 had explained the term upfront fee as below:-

"13. From the rival contentions and the grounds of appeal, it appears that the following points arise for determination:

(a) Whether in the light of Article 2.9(b) of the Common Loan Agreement, the Court was justified in ordering the refund of the upfront fee, when the parties had mutually agreed that the same shall be non-refundable?

(b) Whether the breach of the agreement was on the part of the plaintiff, entitling the bank to invoke the non-refundable clause?

(c) Whether the refund of part of the Up front Fee by the bank can be taken to be an indication that the upfront fee was not to be treated as non-refundable? and

(d) Whether the Court below was right in awarding interest?

Point (a):-

14. The first point arising for determination is as to whether in the light of Article 2.9(b) of the Common Loan Agreement, the upfront fee can be treated to be refundable.

15. There can be no doubt about the legal position that parties to a contract are bound by the terms of the contract. Therefore, generally a fee which is prescribed under an agreement to be non-refundable cannot be directed to be refunded. But there are exceptions to this universal rule.

16. The contention of Mr. Ambadipudi Satyanarayana, learned counsel for the appellant/bank, is that the clause regarding non-refundability of the upfront fee was not a clause in terrorem, but was intended to compensate the bank for blocking funds to the tune of Rs.100 Crores from the date of sanction until the date of disbursement. Though it is not contended by the learned counsel for the appellant nor has it been raised by the bank in the written statement in so many words, we can take it that the bank wanted to treat this upfront fee as an opportunity cost for making available a sum of Rs.100 Crores at all times

(on call) from the date of sanction of the loan till disbursement.

17. At the outset, it should be pointed out that there is no pleading to the effect that the upfront fee was intended to compensate the Bank for keeping an amount of Rs.100 crores available for disbursement. Moreover, if it was actually an opportunity cost, the bank should have normally used the expression "commitment fee ". We can take judicial notice of the fact that in banking parlance, what is charged by lending institutions for blocking a quantum of funds and making them available for the borrowers to withdraw at any time they want, is "commitment fee ".

18. Let us ignore for the present, the nomenclature used and take it that the upfront fee was intended as a compensatory cost for making available a sum of Rs.100 Crores for the benefit of the borrower. Even if we treat the upfront fee paid by the respondent in such a manner, the same would become non-refundable only if anyone or more of the following two conditions are satisfied:

(i) That the bank, in fact, kept locked a sum of Rs.100 Crores for a specified duration of time and hence they became entitled to appropriate the upfront fee

(ii) That there was no breach of the contractual obligations on the part of the bank, but only a breach on the part of the borrower."

25. In the instant case under consideration by this court, the sanction loan amount is Rs.160 lakhs, upfront fee paid is Rs.1,60,000/-. This would become non-refundable only if any of the following two conditions are satisfied:

(i) That the Bank, in fact, kept locked a sum of Rs.160 lakhs for a specified duration of time and hence they became entitled to appropriate the upfront fee. (ii) That there was no breach of the contractual obligations on the part of the bank, but only a breach on the part of the borrower.

In this case the Bank never pleaded in the written statement that they blocked an amount of Rs.160 lakhs to be disbursed to the plaintiff. Neither the bank informed the applicant about their cancellation of letter of intent in time. In fact, this court could see from Ex.A2 the Bank have taken nearly one year after receipt of the upfront money to inform

their intention to cancel the letter of intent. That too after the applicant wrote a letter dated 28/03/2000 demanding refund.

26. In this case, bank had pleaded that there was suppression of fact touching upon the creditworthiness of one of applicant company promoter. Their inference about the creditworthiness of the applicant was not made known to the Applicant in time. After issuance of the letter of intent before commencement of disbursement of loan, three events should have followed. First, Board Resolution authorizing any one from the applicant company to represent them and sign the loan agreement. Second, execution of loan agreement between the applicant company and SIDBI and Third, payment of upfront fee of 1% and inform the schedule of disbursement of loan.

27. The facts on record show that the 1% upfront fee paid on 05/04/1999 . The Board of Directors of the applicant company has passed resolution on 10/04/1999 authorizing a person to represent them. Thereafter in normal course the parties should have entered into loan agreement and based on the terms of the loan agreement, loan amount should have been disbursed. In this case, the last two events never happened.

28. Based on the records it is clear that the money collected under the head upfront fee retained by the bank without any quit pro quo for more than a year without any assignable reason. Hence, the decree passed by the first appellate court is to be confirmed.

29. Accordingly, the Second Appeal is dismissed with costs. Consequently, connected Miscellaneous Petition is closed.

Sd/-

Assistant Registrar (CO)

//True Copy//

Sub Assistant Registrar

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To:

- 1.The First Additional District Judge, Coimbatore.
- 2.The Second Additional Sub Judge, Coimbatore.

+1cc to Mr.Sarvabhauman Associates, Advocate, S.R.No.27567

S.A.No. 587 of 2010
and
M.P.No.1 of 2010

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