IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON	PRONOUNCED ON
05.01.2022	15.02.2022

CORAM

THE HONOURABLE MR. JUSTICE M.DHANDAPANI

W.P. NO. 20648 OF 2021
AND
W.M.P. NO. 21908 OF 2021

Rahoul Jain ..Petitioner

- Vs -

1. Reserve Bank of India
   Fort Glacis, No.16
   Rajaji Salai, Chennai 600 001.

2. RBL Bank Ltd.
   thro' its Chairman & Managing Director
   1st Lane, Shahupuri
   Kolhapur 416 001, Maharashtra.

3. Kotak Mahindra Bank Ltd.
   thro' its Chriaman & Managing Director
   Regd. Office at 27BKC, C-27, G-Block
   Bandra Kurla Complex, Bandra (E)
   Mumbai 400 051.
   Zonal Office at
   No.555, Capital Building
   Anna Salai, Opp: Sun TV
   Teynampet, Chennai 600 018.

4. State Bank of India
   thro' its Chairman & Managing Director
   Corporate Centre at
   State Bank Bhavan, Madam Cama Road
   Nariman Point, Mumbai 400 021
   Maharashtra
   Zonal Office at, Mannadi
   Chennai Port Trust, Chennai 600 001.

5. IDFC First Bank Ltd.
   thro' its Chairman & Managing Director
   KRN Tower, 7th Floor
   No.1, Harrington Road
   Chetpet, Chennai 600 031.

6. HDFC Bank Ltd.
   thro' its Chairman & Managing Director
   Regd. Office at :
   House Senapati Bapat Marg
   Lower Peral,
   Mumbai 400 013.

7. Doha Bank QPSC
   thro' its Chairman & Managing Director
   Corporate Office at :
   Sakhar Bhavan, Ground Floor
   Plot No.230, Block No.III
   Backbay Reclamation, Nariman Point
   Mumbai 400 021
   Zonal Office at :
   No.9, Anna Salai
   Triplicane,
   Chennai 600 002.

8. DBS Bank India Ltd.
   thro' its Chairman & Managing Director
   Regd. Office : Ground Floor Nos. 11 & 12
   Capital Point, BABA Kharak Singh Marg
   Connaught Place, Delhi 110 001.
   Zonal Office at :
   LIC Buinding
   806, Anna Salai,
   Chennai 600 002.

9. IDBI Bank Ltd.
   thro' its Chairman & Managing Director
   Regd. Office : IDBI Tower
   World Trade Complex, Cuffee Parade
   Mumbai 400 005.
   Zonal Office at : 115, Anna Salai
   Opp. to Ashok Leyland
   Gotha Medu Housing Board
   Saidapet, Chennai 600 015.

10. Indian Bank
    thro' its Chairman & Managing Director
    Regd. Office No.66, Rajaji Salai
    Chennai 600 014.

11. Citi Bank N.A.
thro' its Chairman & Managing Director
Corporate Office at : 14th Floor
First International Financial Centre
G Block, Bandra Kurla Complex
Bandra (E), Mumbai 400 098.
Zonal Office at :
No.2, Club House Road
Express Estate, Thousand Lights
Chennai, Tamil Nadu 600 002.

12. ICICI Bank Ltd.
thro' its Chairman & Managing Director
Regd. Office at : ICICI Bank Tower
Near Chalki Circle, Old Padra Road
Vadodara 390 007.
Zonal Office at :
Arihant Insight
Baba Nagar, Jaswant Nagar
Industrial Estate, Ambattur
Chennai, Tamil Nadu 600 058.

13. Capricon Food Products India Ltd.
thro' its Resolution Professional
Mr. J.Karthiga, Insolvency Professional
Plot No.100, Door No.C, 4th Avenue
Shanthi Colony, Anna Nagar,
Chennai 600 040. ..Respondents

Writ Petition filed under Article 226 of the Constitution of India praying this Court to issue a writ of certiorari by setting aside the coercive action taken by respondent No.2 to 12 with respect to declaring the account of M/s.Capricorn Food Products India Ltd., the petitioners as 'fraud' in terms of RBI Master Circular bearing No.BI/DBS/2016-2017/28 DBS.CO.CFMC.BC.No.1/23.04.001/2016-17 dated 10.07.2016.

For Petitioners: Mr.N.R.Elango, SC, for
Mr. Anand Merathia

For Respondents: Mr. R.Rajesh for R-9
Mr. B.Chetan Sagar for R-2
Ms. Ananda Gomathy for R-3
Mr. Vipin Warrier for R-4
Mr. T.Sundarajan for R-10
Mr. V.V.Shivakumar for R-5
Mr. Shivakumar for R-12
Mr. T.Ravichandran for R-13

ORDER

The present petition has been filed against the issuance of Red Flag notice, issued by the 2nd respondent, the a member of the consortium of banks against the 13th respondent, in terms of the RBI Circular, without following the principles of natural justice and to set aside the same.

2.It is the case of the petitioner that he was a shareholder, promoter and erstwhile Managing director of the 13th respondent. It is the further averment of the petitioner that the petitioner company constituted a consortium and all the loans/security documents with the petitioner were jointly executed by and in favour of the consortium of which State Bank of India was appointed as the Lead Bank in the consortium. It is further averred by the petitioner that the consortium of lenders entered into a capital working consortium agreement and other related documents and in that regard a security trustee was also appointed.

3.It is the further averment of the petitioner that due to economic slow down as well as delayed realisation of receivables, there was cash flow mismatch, which was appraised by the 13th respondent to the lenders about the liquidity constraints faced by it and, thereafter, in the year 2019-2020, the 13th respondent also faced financial distress.

4.It is the further averment of the petitioner that relying on the ASM audit report dated 7.3.20, the 2nd respondent, misconceived itself that the company failed to maintain the required level of transparency in terms of submission of data to the lenders of the Consortium, raised objections. In view of the objections raised by the 2nd respondent, second ASM report was requisitioned. However, without waiting for the report, the 2nd respondent classified the account of the 13th respondent as a "Red Flag Account" (for short 'RFA') by invoking the circular of the Reserve Bank of India, which act of the 2nd respondent is in gross violation of Clause 8.3.3 of the said circular of the Reserve Bank of India, as it does same does not satisfy the threshold limit for RFA mandated in the said circular. It is the averment of the petitioner that the RFA classification by the 2nd respondent is erroneous and against the spirit of the consortium and in blatant violation of the circular issued by the Reserve Bank of India.

5.It is the further averment of the petitioner that even the act of the 2nd respondent has been deprecated by the other members of the consortium, in the meeting, where the other members of the consortium also were not in favour of the RFA issued by the 2nd respondent. It is the further averment of the petitioner that aggrieved by the RFA issued by the 2nd respondent, the company filed C.S. No.31/2020 before this Court in which this Court granted an order of interim injunction in favour of the company.

6.It is the further averment of the petitioner that subsequent to the said order, relying of the ASM reports, which were filed by then, the 2nd respondent recalled the credit facilities extended to the company and invoked the guarantees provided.

7.It is further averred that in the meanwhile the National Company Law Tribunal (for short 'NCLT'), vide its order dated 13.11.2020 initiated Corporate Insolvency Resolution Process (for short 'CIRP') and resolution profession has been appointed by NCLT for taking over management and control of the company, who will be acting on the advice and instructions of the Committee of Creditors (for short 'CoC') constituted by the Financial Creditors of the company. It is further averred that subsequent to the order of NCLT, this Court had also vacated the interim injunction, vide its order dated 4.12.20.

8.It is the further averment of the petitioner that in the meeting of the CoC, the 2nd respondent had informed the members that the Bank had already classified the account of the company 'Fraud' in May, 2021, based on the Stock Verification Audit, Transaction Audit and ASM report. It is the averment of the petitioner that the Transaction Audit Report, relied on by the 2nd respondent was prepared based on the directions given by respondents 2 to 12, who are also part of the CoC. It is the stand of the petitioner that there is a gross violation of principles of natural justice and the doctrine of audi alteram partem were not followed and the petitioner was not provided with an opportunity to respond to the observations made by the Transaction Auditor.

9.It is the further averment of the petitioner that the 3rd respondent, in the meeting of the CoC informed that the account of the company has been declared as fraud and the Resolution Professional, viz., the 13th respondent was asked to record the same in the minutes of the meeting dated 13.8.2021. Though the petitioner sought the copy of the audit report, however, the same was not provided to the petitioner. The account of the company was held to be 'Fraud' and declared so without an opportunity of hearing and even in the forensic audit, the Forensic Auditor had informed that there was no instructions from the CoC to share the forensic audit report with the petitioner. The above act of the CoC is in gross violation of the principles of natural justice and aggrieved by the act of the CoC in declaring the account of the company as fraud and also the act of the 2nd respondent in terming the account of the company as RFA, the present petition has been filed.

10.Learned senior counsel appearing for the petitioner submits that the act of the 2nd respondent in classifying the account of the company as a fraud without affording any opportunity is in blatant violation of clause 8.9.4 and 8.9.5 and that the minimalistic requirement before any action could be taken against the company is affording an opportunity of hearing, which the company was not provided with, thereby there is clear infraction of principles of natural justice, which is suffice to set aside the order impugned herein.

11.It is the further submission of the learned senior counsel that if an opportunity had been provided, the petitioner would have submitted explanations/clarifications, which, even, could have resulted in the account of the company not being declared Fraud, and, thereby, no consequence of prejudice would have been caused to the petitioner. It is the further submission of the learned senior counsel that the act of the 2nd respondent in making the account of the company RFA, without affording opportunity and further the documents relied on by the CoC to declare the account of the company as RFA, clearly violates the basic tenets of the clauses accepted by the parties and is in violation of principles of natural justice.

12.It is the further submission of the learned senior counsel that it has been the consistent view of the Courts that an opportunity has to be granted to the party, before any order is passed against the said party and in the present case, the act of CoC in declaring the account of the company as Fraud in terms of the RBI circular, and inspite of the order of interim injunction granted by this Court in the suit in C.S. No.231/2020, the decision of the consortium led by the 3rd respondent in declaring the account of the company as RFA, is against a clear attempt to subvert the order granted in the suit. Accordingly, he prays for allowing the present petition.

13.Learned counsel appearing for the 2nd respondent, who had issued the RFA on the company, submitted that after analysing the ASM audit report and other transactions, entertaining a grave doubt as to the manner in which the affairs of the company had been conducted, the 2nd respondent has declared the account of the company as RFA. It is the further submission of the learned counsel for the 2nd respondent that though the petitioner claims that it is facing some crisis, but that it is only due to the economic slow down and delayed realisation of the receivables, however, the said stand of the petitioner gets thrashed out on its own accord in the company having approached the NCLT under the Insolvency and Bankruptcy

Code for initiation of Corporate Insolvency Resolution Process. It is therefore the submission of the learned counsel for the 2nd respondent that the act of the 2nd respondent in declaring the account of the company as RFA stands vindicated.

14.Further it is the submission of the learned counsel for the 2nd respondent that the notice of red flagging the account of the company was within the domain of the consortium and not in the public domain and that being the case, the grievance expressed by the petitioner that the company had lost its reputation and status because of the red flagging of the account of the company is wholly unsustainable. Further, the company having subjected itself to the Corporate Insolvency Resolution Process, the petitioner cannot come before this Court and claim that the act of the 2nd respondent is vindictive as there is no material to hold that the company has not committed any fraud. It is the further submission of the learned counsel for the 2nd respondent that the account being declared as RFA is based on the decision of the consortium and that the intimation for declaring the account of the company as RFA by the 2nd respondent is an internal communication, on the basis of the circular issued by the Reserve Bank of India, and the said decision of the 2nd respondent cannot be put in issue before this Court, more especially to claim infraction of principles of natural justice. It is the further submission of the learned counsel for the 2nd respondent that in the meeting of CoC, in which the company was also represented, decision was taken to declare the account of the company as RFA and, therefore, the claim of the petitioner for providing a separate opportunity upon notice does not arise and the same is nothing but a technicality on which the petitioner tries to rest his whole case. The stock audit of the firm by the Resolution Professional has also revealed fraudulent acts in the form of cooked up stock statement and, therefore, the said statement of the Resolution Professional also vindicates the action of the CoC. Therefore, it is prayed that there are no merits in the present writ petition.

15.This Court paid its careful consideration to the submissions advanced by the learned counsel appearing on either side and perused the materials available on record.

16.A perusal of the materials available on record reveals that on the basis of the first ASM Audit Report, the 2nd respondent has taken steps to declare the account of the company as RFA, which action was deliberated in the meeting of the consortium. Further to the said meeting, further ASM Audit was requisitioned by the consortium and accordingly, further ASM audit was conducted and report was filed.

17. The whole crux of the issue raised by the petitioner is that before the subsequent ASM Audit Report could be received, the 2nd respondent had declared the account of the company as RFA. The grievance of the petitioner is that before declaring the account as RFA, no notice or opportunity has been granted to the company.

18. In this regard, it is to be pointed out that even the affidavit of the petitioner reveals that initially in the meeting held on 29.2.20, the Consortium of Lenders had not unilaterally decided to accept the stand of the 2nd respondent to declare the account of the company as RFA. The above act of the Consortium clearly reveals that what has been circulated is a communication between the members of the consortium as to the standing of the company on the books of account of the consortium. The account was sought to be declared as RFA as the ASM Audit Report had given a gloomy picture according to the 2nd respondent. However, as pointed out above, further ASM Audit Report was called for and based on discussion in the consortium meeting dated 5.5.20, based on the forensic audit, red flagging of the account was decided to be taken up. From the above, it is evident that even as on 5.5.20, the account was not red flagged, but the communication that emanated from the 2nd respondent is only an internal communication between the members of the consortium with regard to the status of one of the account.

19.When the communication itself is an internal communication between the members of the consortium for appraisal of a particular account, the account of the company not having been red flagged as per the circular issued by the Reserve Bank of India, the stand of the petitioner that even for a communication to be circulated between the members of the consortium, notice ouought to have been given to the petitioner is wholly misconceived. If this Court accepts the said stand of the petitioner that even the communication between the members of the consortium could be circulated only after the petitioner is put on notice, then it would literally mean that it is not the consortium, which is holding the ace, but it would be the petitioner, who is a borrower, who is holding the ace. Such an decision would render the consortium a fancy piece and its existence only on paper.

20. It is further evident from the record that against the action of the 2nd respondent to declare the account of the company as RFA, civil suit in C.S. No.231/2020 was filed before this Court, which resulted in an interim order of injunction.

21. In the interregnum, due to the financial difficulties of the petitioner, a petition under Section 9 of the Insolvency

and Bankruptcy Code, 2016 was initiated against the company before the NCLT and NCLT, vide order dated 13.11.20 had appointed Interim Resolution Professional, who was subsequently appointed as the Resolution Professional by the CoC. From the above, it is fairly evident that all is not well with the company and that the company was in severely liquidity crunch resulting in the petition before the NCLT. Therefore, the stand of the petitioner that the company was performing well, but for some minor financial difficulties due to delayed realisation of receivables, would stand wholly defeated in view of the order passed by NCLT by appointing an interim resolution professional, who has since been appointed as Resolution Professional by the CoC. Therefore, even prior to 13.11.20, it is clear that all is not well with the company. Therefore, in such a backdrop, the earlier action of the 2nd respondent in communicating its thoughts as to the status of the account of the company as RFA cannot be found fault with. It is also to be pointed out that pursuant to the order of NCLT appointing interim resolution profession, the interim order granted by this Court in C.S. No.231/20 also stood vacated and the civil suit is pending consideration.

22.The Resolution Professional, who has since been appointed to take charge of the affairs, control and management of the company by the CoC, has submitted a memo before this Court, in which it has been stated as under :-

> "3. This respondent has been requesting the petitioner who was the Managing Director of the Corporate Debtor for the stock statement and after much persuasion the stock statement was provided.
>
> 4. This respondent had her own doubts about the stock statements provided by the respondent and therefore placed the issue with regard to the stock statement in the first meeting of the Committee of Creditors (CoC) held on 14.11.2020. This respondent was brought to the notice of the members of CoC how crucial the stock audit in the present case in view of the perishable nature of the product.
>
> 5. The stock audit report was received by this respondent on 12.02.2021 and this respondent having gone through the stock audit report has called for explanation from the petitioner herein, the suspended director of the Corporate Debtor. A perusal of the stock audit report would reveal that there is a huge difference in value

with reference to the stock statement which was given to this respondent after much persuasion. While the value as per the stock statement given by the petitioner was Rs.142.74 Crores, the actual value as per the report of the stock auditor was around Rs.6.78 Crores."

23.The above memo of the Resolution Professional clearly reveal the devious attitude being followed by the petitioner in handling the affairs of the company. When the stock auditor report reveals the above discrepancies in the value of the items in stock, the ASM report, which had formed the basis of the communication being circulated amongst the members of the consortium, cannot be termed to be without any material, as the 2nd respondent, being a banking organisation has to keep watch on its lenders, without which the financial position of the bank would be in doldrums. Though this Court is not taking the memo as a piece of document to base its findings, but definitely the said memo has persuasive value, insofar as the Resolution Professional is a third party, who has no nexus with either of the parties to the lis.

24.Therefore, from the above sequence of events, it clearly transpires that the 2nd respondent has taken the step of circulating the note amongst its members with regard to the account of the company to be declared as RFA which was deliberated upon by the CoC before the accounts of the company was declared as Fraud stood vindicated from the initiation of proceedings for Corporate Insolvency Resolution Process before the NCLT and the subsequent act of appointing an interim resolution professional. The initial act of the 2nd respondent in circulating the note amongst its members is not necessary to be brought to the knowledge of the petitioner and no notice need be served on the petitioner as the same is a mere internal communication, which in no way affects or jeopardizes the status of the petitioners in the eyes of either the public or the other financial establishments.

25.For the reasons aforesaid, this Court is of the considered view that the act of the 2nd respondent in not issuing notice to the petitioner before circulating the note amongst the members of the consortium for declaring the account of the company as RFA could be said to be in violation of principles of natural justice and against the doctrine of audi alteram partem. Therefore, the act of the 2nd respondent does not warrant interference and this writ petition is liable to be dismissed.

26.Accordingly, this writ petition fails and the same is dismissed. Consequently, connected miscellaneous petition is closed. However, there shall be no order as to costs.

Sd/-
Assistant Registrar(CS III)

//True Copy//

Sub Assistant Registrar

GLN

To

1. Reserve Bank of India
   Fort Glacis,
   No.16, Rajaji Salai,
   Chennai 600 001.

2. The Chairman & Managing Director
   State Bank of India
   State Bank Bhavan, Madam Cama Road
   Nariman Point, Mumbai 400 021
   Maharashtra
   Zonal Office at,
   Mannadi, Chennai Port Trust,
   Chennai 600 001.

3. The Chairman & Managing Director
   Indian Bank
   Regd. Office No.66, Rajaji Salai
   Chennai 600 014.

+1cc to Mr.Chethan Sagar, Advocate, S.R.No.9815

+2cc to Mr.Rishi Srinivas, Advocate, S.R.No.9474

W.P.NO.20648 OF 2021

AK-II(CO)
RGA(01/03/2022)