THE HONOURABLE SRI JUSTICE K. LAKSHMAN

WRIT PETITION Nos.36248 AND 37283 OF 2022

COMMON ORDER:

The *lis* involved in both the writ petitions and the respondents are same, both the writ petitions were heard together and decided by way of this common order.

2. These two writ petitions are filed to declare the minutes of resolution/order of 3rd respondent dated 25.08.2022 communicated to the petitioner vide letter dated 14.09.2022 confirming the minutes and resolution/order of 2nd respondent in minutes of meeting No.15/2021-22, dated 09.12.2021 wherein the petitioner was declared as willful defaulter, as illegal and consequently quash the same.

3. Heard Sri P. Somasekhara Naidu, the learned counsel for the petitioners, Sri M. Raghavendra Satya Gopal, learned standing counsel appearing for respondents. Perused the record.

(For the sake of convenience, the parties are referred to as they are referred in W.P.No.36248 of 2022).

4. The grievance of the petitioners is that respondent Nos.2 and 3 have passed the impugned orders dated 09.12.2021 and 25.08.2022 without following the procedure laid down under RBI Master Circular

on willful defaulters dated 01.07.2015 and also in violation of the principle laid down by the Apex Court.

5. According to the petitioner in W.P.No.36248 of 2022, he is the erstwhile Director of M/s Lanco Solar Private Limited (LSPL). Whereas, according to the petitioner in W.P.No.27283 of 2022, he joined service in LSPL in the year 2010 as Chief Operating Officer-Manufacturing (COOM) and was promoted as whole time Director on 26.11.2012 in his professional capacity. Though he was designated as whole time Director, he was in charge of the technical issues pertaining to the manufacturing of solar materials such as poly silicon and modules of the borrower and he had no role in the financial dealings of the borrower. He had continued in the said capacity till 08.02.2017 and he had submitted resignation to the directorship of the said company.

6. According to the petitioners in both the writ petitions, 2nd respondent/Identification Committee and 3rd respondent/Review Committee without following the procedure laid down under RBI Master Circular on willful defaulters, passed orders dated 09.12.2021 and 25.08.2022.

7. In view of the aforesaid specific contentions, it is relevant to note that Clause No.3 of the said Master Circular on willful defaulters

dated 01.07.2015 of RBI, deals with mechanism for identification of willful defaulters. The said Clause is relevant and it is extracted below:-

> Clause No.3:- Mechanism for identification of Wilful Defaulters:-
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> The mechanism referred to in paragraph 2.5 above should generally include the following:-
>
> (a) The evidence of wilful default on the part of the borrowing company and its promoter/whole-time director at the relevant time should be examined by a Committee headed by an Executive Director or equivalent and consisting of two other senior officers of the rank of GM/DGM.
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> (b) If the Committee concludes that an event of wilful default has occurred, it shall issue a Show Cause Notice to the concerned borrower and the promoter/ whole time director and call for their submissions and after considering their submissions issue an order recording the fact of wilful default and the reasons for the same. An opportunity should be given to the borrower and the promoter/ whole-time director for a personal hearing if the Committee feels such an opportunity is necessary.
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> (c) The Order of the Committee should be reviewed by another Committe headed by the Chairman/Chairman & Managing Director or the Managing Director & Chief Executive Officer/CEOs and consisting, in addition, to two independent directors/non-executive directors of the bank and the Order shall become final only after it is confirmed by the said Review Committee. However, if the Identification Committee does not pass an Order declaring a borrower as a wilful defaulter, then the Review Committee need not be set up to review such decisions.

8. As per the aforesaid clause, the Identification Committee shall examine the evidence of the willful default on the part of the borrower company and its promoters, whole time Directors at the relevant time. If the Committee concludes that an event of willful default has occurred, it shall issue a Show Cause Notice to the concerned borrower and the

Promoter/Wholetime Director and call for their submissions and after considering their submissions issue an order recording the fact of wilful default and the reasons for the same. An opportunity should be given to the Borrower and the Promoter/Wholetime Director for a personal hearing if the Committee feels such an opportunity is necessary. The order passed by the Identification Committee should be reviewed by Review Committee and the said order shall be final only after it is confirmed by the Review Committee.

9. According to the petitioner in W.P.No.36248 of 2022, he has not received show cause notice, dated 26.02.2021. It was sent to his old address i.e. Plot No.1277, Road No.63/A, Jubilee Hills, Hyderabad-500033. According to him, he has already intimated the Bank about the change of his address in 2020 itself. Even then, the said show cause notice dated 26.02.2021 was addressed and sent to his aforesaid old address. Thus, without serving a show cause notice, dated 26.02.2021 on the petitioner and without giving an opportunity to him, the order dated 09.12.2021 was passed by the Identification Committee and the said order was communicated to the petitioner vide letter dated 20.12.2021. Therefore, he had addressed a letter dated 07.01.2022 to 2nd respondent bank with a request to receive and withdraw the said decision of

declaring the petitioner as willful defaulter. Vide e-mail dated 10.01.2021, respondent bank enclosed a copy of the show cause notice and requested the petitioner to submit his explanation before the Review Committee. He had replied to the said e-mail dated 10.01.2021 and 11.01.2022 specifically contending that the said decision dated 09.12.2021 declaring the petitioner as willful defaulter is in violation of the principles of natural justice and in violation of the procedure laid down under Clause No.3 of the aforesaid RBI Master Circular on willful defaulters dated 01.07.2015. He had addressed letter on 18.01.2022 to the respondent Bank with a request to review the aforesaid orders dated 09.12.2021 and 26.08.2021 and also letters to the Liquidator of the LSPL. He has also requested the Liquidator to furnish certain documents which the Liquidator refused. The respondent Bank vide e-mail dated 08.03.2022 requested the petitioner to appear before the Review Committee. Vide letter dated 14.03.2022, the petitioner informed the respondent Bank to furnish all the documents to enable him to go through the same and submit his reply/explanation to the Review Committee effectively. He has sent reply dated 29.03.2022 to the letter addressed by the Liquidator dated 22.02.2022. Thus, according to the petitioner in W.P.No.36248 of 2022, he has not received the aforesaid show cause notice dated 26.02.2021 and the aforesaid orders dated 09.12.2021 and 25.08.2022 passed by both the Identification Committee and Review Committee are in violation of the aforesaid Master Circular on willful defaulter dated 01.07.2015 of RBI.

10. However, respondents have filed a counter contending that they have served show cause notice and after following the procedure laid down under the aforesaid Master Circular dated 01.07.2015 of RBI and both the Identification Committee and Review Committee have passed the aforesaid orders. There is no violation of any procedure. Even then, the petitioners herein have filed the aforesaid writ petition.

11. As per Clause No.3, the respondent Nos.2 and 3 shall follow the following procedure which is mandatory:-

i. 2nd respondent/Identification Committee shall examine the evidence of the default on the part of the Borrower-Company and its Promotor/Wholetime Director at the relevant time.

ii. If the Committee concludes that an event of willful default has occurred, it shall issue a show cause notice to the concerned borrower and the promoter/Wholetime Director,

iii. Shall consider their submissions and issue an order regarding the fact of willful default and the reasons for the same.

iv. If the Committee feels, it shall give an opportunity to the Borrower and the Promoter/Wholetime Director of personal hearing.

v. The order passed by the Identification Committee shall be reviewed by the Review Committee.

12. From the perusal of the record including the aforesaid show cause notice dated 09.12.2021, and letter dated 20.12.2021, e-mail dated 10.01.2022, Liquidator's letter dated 22.02.2022 and respondent Bank e-mail dated 08.03.2022 would reveal that the petitioner has informed the respondent Bank with regard to the fact that he is staying at Plot No.101 and 102, G-Block, First Floor, Castriona Apartment, Ambience Island, NH-8, Gurgaon 122001. His Hyderabad Address is Plot No.1277, Road No.63, Jubilee Hills, Hyderabad. According to the petitioner, vide his letter dated 20.09.2020, he has informed respondent-Bank about change of the aforesaid address.

13. It is relevant to note that in the order dated 09.12.2021 of 2nd respondent, there is specific mention that the Committee has observed that show cause notice was issued to all the concerned i.e. Borrower, Directors, and Guarantors. Show cause notices are delivered to all except Mr.Lagadapati Madhusudhan Rao, the petitioner in W.P.No.36248 of 2022. Despite the same, 2nd respondent-Identification Committee had declared the petitioner herein as willful defaulter. Therefore, according to this Court, the aforesaid order dated 09.12.2021

of 2nd respondent declaring the petitioner as willful defaulter is in violation of the principles of natural justice and also in violation of the procedure laid down under Clause No.3 of the aforesaid Master Circular dated 17.02.2015 on willful defaulters of RBI.

14. It is also relevant to note that according to the petitioner, he had informed about his change of address vide his letter dated 20.09.2020 itself. He has filed a copy of the said letter and proof of receipt of the same by the respondent bank. There is no denial of the said fact. Even in the correspondence between the petitioner and respondent bank, the address of the petitioner i.e. Gurgaon, Haryana, is mentioned. Even the orders dated 09.12.2021 and 08.03.2022 were addressed to the petitioner to his both addresses i.e. Hyderabad as well as Gurgaon, Haryana.

15. Referring to the show cause notices, postal receipts and postal covers returned unserved, respondent bank contends that they have served show cause notice on the petitioner at his Hyderabad Address and the petitioner has not informed about change of his address. The respondent bank has filed only postal receipts in proof of postage of the aforesaid show cause notice dated 26.02.2021. Thus, the respondents have passed the aforesaid orders dated 09.12.2021 and 25.08.2021

without serving show cause notice, dated 26.02.2021 and without giving them an opportunity of hearing and therefore, the same is in violation of the principles of natural justice and the procedure laid down under Clause No.3 of the Master Circular dated 01.07.2015 of RBI.

16. With regard to the petitioner in W.P.No.37283 of 2022, according to him, he was initially appointed as COO and thereafter, he has designated as Wholetime Director. He was ceased to be a Director on 08.02.2017 itself. In proof of the same, he has filed a copy of the information obtained of Ministry of Corporate Affairs, Union of India. According to him, he has submitted resignation. The said fact was informed to the Ministry of Corporate Affairs. According to him, respondents have not served show cause notice, dated 26.02.2021 and he has received the order dated 09.12.2021 along with letter dated 20.12.2021. Therefore, vide his letter dated 05.01.2022, he has informed 2nd respondent that he has not received show cause notice and that he has already submitted resignation. He has no control over the financial aspects of LSPL. Vide letter dated 10.01.2022, 2nd respondent informed about service of a notice on the petitioner which is factually incorrect. Vide letter dated 10.01.2022, the petitioner informed the respondents that without show cause notice and without an opportunity he cannot be

expected to appear before the Review Committee. He has submitted another letter dated 13.01.2022 stating that without considering the same, the Review Committee has passed order dated 25.08.2022. Thus, the entire action of the respondents is in violation of the principles of natural justice and procedure laid down under Clause No.3 of the Master Circular on willful defaulter dated 01.07.2015 of RBI.

17. However, the respondents in the counter contended that the petitioner has received the show cause notice on 09.03.2021 and even then, he has not submitted any reply. However, they have not disputed with regard to the fact of his resignation to the Directorship of the Company on 08.02.2017. According to the bank, the Company despite being a legal person through its Directors and its Director have committed default, they cannot be allowed go scot free on the terms of the resignation after making company sick. The petitioner resigned on 09.02.2017. The account of aforesaid company become NPA on 31.01.2017 itself during which time the petitioner was whole time Director of the said company. However, the respondent bank has filed a copy of postal receipts but it has not filed proof of service of show cause notice dated 26.02.2021 on the petitioner. However, referring to the postal tracking report, the respondents would contend that the show

cause notice, dated 26.02.2021 was served on the petitioner but the same was not supported by proper evidence. The numbers mentioned on the postal receipts and postal tracking reports are not matching numbers and therefore, it cannot be considered that the said show cause notice was served on the petitioner.

18. As discussed supra, clause No.3 of the aforesaid Master Circular dated 01.07.2015 of RBI on willful defaulters mandates procedure to be followed by the respondent bank. But the respondent bank failed to serve notice on petitioner. Thus, the order dated 09.12.2021 passed by the Identification Committee and the order dated 25.08.2022 passed by Review Committee declaring the petitioner as willful defaulter is in violation of the principles of natural justice and procedure laid down under clause No.3 of the aforesaid Master Circular, dated 01.07.2015.

19. As rightly contended by the learned counsel for the petitioner that the role of Review Committee is only to review the order passed by the Identification Committee. It is Identification Committee which has to examine the evidence of the default on the part of the borrower company, its Directors and come to a conclusion with regard to willful default. It has to consider the explanation submitted by the

Directors, on receipt of the show cause notice. The said procedure is not followed in the present case. Therefore, the respondents bank cannot contend that the petitioners in both the writ petitions failed to appear before the Review Committee.

20. As discussed supra, the very order dated 09.12.2021 passed by the Identification Committee declaring the petitioners in both the writ petitions as willful defaulters is in violation of the principles of natural justice and procedure laid down under Clause No.3 of the aforesaid Master Circular dated 01.07.2015 of RBI on willful defaulters.

21. It is relevant to note that in **SBI Vs. Jah Developers Private Limited**[1] the Hon'ble Apex Court considered the procedure laid down under Master Circular dated 01.07.2015 of RBI and in paragraph No.24 held as follows:-

> 24. Given the above conspectus of case law, we are of the view that there is no right to be represented by a lawyer in the in-house proceedings contained in Para 3 of the Revised Circular dated 1-7-2015, as it is clear that the events of wilful default as mentioned in Para 2.1.3 would only relate to the individual facts of each case. What has typically to be discovered is whether a unit has defaulted in making its payment obligations even when it has the capacity to honour the said obligations; or that it has borrowed funds which are diverted for other purposes, or siphoned off funds so that the funds have not been utilised for the specific purpose for which the finance was made available. Whether a default is intentional, deliberate, and calculated is again a question of fact which the lender may put to the borrower in a show-cause notice to elicit the borrower's submissions on the same. However, we are of the View that Article 19(1)(g) is

[1] 2019 6SCC 787

> attracted in the facts of the present case as the moment a person is declared to be a wilful defaulter, the impact on its fundamental right to carry on business is direct and immediate. This is for the reason that no additional facilities can be granted by any bank/financial institutions, and entrepreneurs/ promoters would be barred from institutional finance for five years, Banks/ financial institutions can even change the management of the wilful defaulter, d and a promoter/director of a wilful defaulter cannot be made promoter or director of any other borrower company. Equally, under Section 29-A of the Insolvency and Bankruptcy Code, 2016, a wilful defaulter cannot even apply to be a resolution applicant. Given these drastic consequences, it is clear that the Revised Circular, being in public interest, must be construed reasonably. This being so, and given the fact that Para 3 of the Master Circular e dated 1-7-2013 permitted the borrower to make a representation within 15 days of the preliminary decision of the First Committee, we are of the view that first and foremost, the Committee comprising of the Executive Director and two other senior officials, being the First Committee, after following Para 3(b) of the Revised Circular dated 1-7-2015, must give its order to the borrower as soon as it is made. The borrower can then represent against such order within a period of 15 days to the Review Committee. Such written representation can be a full representation on facts and law (if any). The Review Committee must then pass a reasoned order on such representation which must then be served on the borrower. Given the fact that the earlier Master Circular dated 1-7-2013 itself considered such steps to be reasonable, we incorporate all these steps into the Revised Circular dated 1-7-2015. The impugned judgment[1]. 2 is, therefore. set aside, and the appeals are allowed in terms of our judgment. We thank the learned Amicus Curiae, Shri Parag Tripathi, for his valuable assistance to this Court.

Thus, the declaration of willful defaulter will have its own civil consequences and therefore, the respondents bank shall necessarily follow the aforesaid procedure. As discussed supra, in the present case, the respondents have not followed the aforesaid procedure which is mandatory while declaring the petitioners as willful defaulters. Therefore, both the orders dated 09.12.2021 passed by the Identification

Committee and the order dated 25.08.2022 passed by Review Committee of the respondents Bank are liable to be set aside.

22. With regard to the contentions of the petitioners in both the writ petitions, passing the order by the NCLT and non-furnishing of committee report and documents etc., they are at liberty to raise the same before the Identification Committee on receipt of the show cause notices.

23. In view of the aforesaid discussion, without going into the merits and demerits of the case, only on the aforesaid grounds of violation of the principles of natural justice and violation of procedure laid down under Clause No.3 of the Master Circular on willful defaulters dated 01.07.2015 of RBI, both the writ petitions are allowed. The order dated 09.12.2021 passed by 2nd respondent declaring the petitioners as willful defaulters and order dated 25.08.2022 passed by the 3rd respondent/Review Committee declaring the petitioners as willful defaulters, confirming the order of 2nd respondent dated 09.12.2021 are hereby set aside. The respondents are directed to strictly follow the aforesaid procedure laid down under Clause No.3 of the Master Circular on willful defaulters dated 01.07.2015 of RBI and pass appropriate orders afresh.

Consequently, miscellaneous petitions pending, if any, shall stand closed.

K. LAKSHMAN, J

Date:01.03.2023
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