IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 10.04.2024

CORAM:

THE HONOURABLE MR. JUSTICE **G.K.ILANTHIRAIYAN**

W.P.No.12605 of 2022
and
W.M.P.Nos.12052, 12053, 29456 and 31653 of 2022

1. Ram Charan Company Private Limited,
Represented by its Managing Director
No. 505, 5th Floor, Delta Wing, Raheja Towers,
Old No. 113-134, New No. 177, Anna Salai,
Chennai – 600 002.
(Transposed as per order dated
10.04.2024 made in
W.M.P.No.29767 of 2022
in W.P.No.12605 of 2022)

2. Kaushik Palicha,
Managing Director of
Ram Charan Company Private Limited,
No.505, 5th Floor, Delta Wing,
Rajeha Towers, Old No.113-134,
New No.177, Anna Salai,
Chennai – 600 002.
(Cause title amended as per order
dated 10.04.2024 made in
W.M.P.No.29769 of 2022
in W.P.No.12605 of 2022) ...Petitioners

-Vs-

1. Reserve Bank of India
Fort Glacis, No. 16, Rajaji Salai,
Chennai – 600 001.
2. IDFC First Bank Limited,

Represented by its Authorized Representatives,
Having its Registered/Branch Office at:
KRM Tower, 7th Floor,
No. 1, Harrington Road,
Chetpet, Chennai – 600 031. ...Respondents

Prayer : Writ Petition filed under Article 226 of Constitution of India praying for the issuance of a Writ of Certiorarified Mandamus, calling for the records of the 1st respondent culminated in master circular RBI/DBS/2016-17/28 DBS.CO.CFMC.BC.No.1/23.04.001/2016-17 dated July 01, 2016 (updated as on July 03, 2017) issued by the 1st respondent under Section 35A of the Banking Regulation Act, 1949 and to quash the same and consequently remove the fraud report filed against the 3rd respondent by the 2nd respondent based on the impugned circular.

For Petitioners	: Mr.Sanjay Pinto
For R1	: Mr.C.Mohan for M/s.King and Partridge
For R2	: No appearance

ORDER

This Writ Petition has been filed challenging the circular issued by the first respondent dated 01.07.2016 under Section 35 A of the Banking Regulation Act, 1949.

2. Heard the learned counsel for the petitioners and the learned counsel for the first respondent and perused the materials available on record. There is no representation on behalf of the second respondent.

3. The petitioner Company is involved in the business of chemicals and

polymers. The petitioner Company availed loan to the tune of Rs.40 Lakhs for its working capital from the second respondent, vide Sanction Letter dated 19.01.2018. It also availed various credit facilities/loans from other private sector banks under the Multiple Banking Arrangements such as IDFC First Bank Limited i.e, the second respondent herein, Citi Bank, Axis Bank Limited, DBS Bank India Limited, RBL Bank Limited. Though the petitioner Company had initially been making payments as per the schedule, due to Covid – 19 pandemic and subsequent lockdowns, the entire business crippled and the petitioner Company committed default. Therefore, the second respondent had issued Loan Recall Notice dated 19.05.2021, thereby recalling the entire loan outstanding sum of Rs.38,86,84,063/-, which was due and payable on 05.05.2021, within seven days.

4. Thereafter, by an email dated 28.05.2021, the second respondent sought for information and clarifications with respect to the accounts of the Company. Further, the second respondent stated that the Red Flagged Account classification and reported the same to the first respondent, as per RBI Master circular dated 01.07.2016, updated as on 03.07.2017, if the Company fails to provide response within ten days from the date of the said email. By the reply dated 10.06.2021, the petitioner pleaded for restructuring of the loan and

pointed out that the proposed Red Flagging of its account is incorrect. However, the second respondent classified the account of the Company as Red Flagged Account.

5. The learned counsel appearing for the petitioners raised a specific ground that the declaration of Red Flagged Account is a clear violation of principles of natural justice. Pursuant to the said declaration, the Company cannot be declared as a fraud account and also subsequently FIR has been registered. All these sanctions are violation of Principles of natural justice.

6. In support of his contentions, he relied upon the Judgment of the Hon'ble Supreme Court of India in the case of ***State Bank of India and others Vs Rajesh Agarwal and others*** reported in ***2023 6 SCC 1,*** wherein it has held as follows:-

> *" 81. Audi alteram partem, therefore, entails that an entity against whom evidence is collected must: (i) be provided an opportunity to explain the evidence against it; (ii) be informed of the proposed action, and (iii) be allowed to represent why the proposed action should not be taken. Hence, the mere participation of the borrower during the course of the preparation of a forensic audit report would not fulfil the requirements of natural justice. The decision to classify an account as fraud involves due application of mind to the facts and law by the lender banks. The lender banks, either*

individually or through a JLF, have to decide whether a borrower has breached the terms and conditions of a loan agreement, and based upon such determination the lender banks can seek appropriate remedies. Therefore, principles of natural justice demand that the borrowers must be served a notice, given an opportunity to explain the findings in the forensic audit report, and to represent before the account is classified as fraud under the Master Directions on Frauds.

....

95. In light of the legal position noted above, we hold that the rule of audi alteram partem ought to be read in Clauses 8.9.4 and 8.9.5 of the Master Directions on Fraud. Consistent with the principles of natural justice, the lender banks should provide an opportunity to a borrower by furnishing a copy of the audit reports and allow the borrower a reasonable opportunity to submit a representation before classifying the account as fraud. A reasoned order has to be issued on the objections addressed by the borrower. On perusal of the facts, it is indubitable that the lender banks did 58 Kranti Associates (P) Ltd. v. Masood Ahmed Khan, (2010) 9 SCC 496 not provide an opportunity of hearing to the borrowers before classifying their accounts as fraud. Therefore, the impugned decision to classify the borrower account as fraud is vitiated by the failure to observe the rule of audi alteram partem. In the present batch of appeals, this Court passed an ad-interim order restraining the lender banks from taking any precipitate action against the borrowers for the time being. In pursuance of our aforesaid reasoning, we hold that the decision by the lender banks to classify the borrower accounts as fraud, is violative of the principles of natural justice. The banks would be at liberty to take fresh steps in accordance with this decision.

....

98. The conclusions are summarized below:

i. No opportunity of being heard is required before an FIR is lodged and registered;

ii. Classification of an account as fraud not only results in reporting the crime to investigating agencies, but *also has other penal and civil consequences against the borrowers;*

iii. Debarring the borrowers from accessing institutional finance under Clause 8.12.1 of the Master Directions on Frauds results in serious civil consequences for the borrower;

iv. Such a debarment under Clause 8.12.1 of the Master Directions on Frauds is akin to blacklisting the borrowers for being untrustworthy and unworthy of credit by banks. This Court has consistently held that an opportunity of hearing ought to be provided before a person is blacklisted;

v. The application of audi alteram partem cannot be impliedly excluded under the Master Directions on Frauds. In view of the time frame contemplated under the Master Directions on Frauds as well as the nature of the procedure adopted, it is reasonably practicable for the lender banks to provide an opportunity of a hearing to the borrowers before classifying their account as fraud.

vi. The principles of natural justice demand that the borrowers must be served a notice, given an opportunity to explain the conclusions of the forensic audit report, and be allowed to represent by the banks/ JLF before their account is classified as fraud under the Master Directions on Frauds. In addition, the decision classifying the borrower's account as fraudulent must be made by a reasoned order; and

vii. Since the Master Directions on Frauds do not expressly provide an opportunity of hearing to the borrowers before classifying their account as fraud, audi alteram partem has to be read into the provisions of the directions to save them from the vice of arbitrariness."

7. Thereafter, the State Bank of India filed a petition to clarify whether the said Judgment is with effect to prospectively or retrospectively. However, the State Bank of India was given an opportunity to file a Review Petition separately. Review Petition was filed by the State Bank of India and by an order

dated 18.07.2023, the Review Petition was dismissed.

8. The State Bank of India had taken a specific stand that the Judgment of the Hon'ble Supreme Court of India may be interpreted in the future to mean that the grant of personal hearing is mandatory though it has not been so directed in the conclusions set out in paragraph 81 of the Judgment. Therefore, the said request was rejected by the Hon'ble Supreme Court of India.

9. Following the said Judgment of the Hon'ble Supreme Court India, the Hon'ble Division Bench of this Court, in the case of ***P.R.Shanmugam and Another Vs Regional Manager, Reserve Bank of India*** reported in ***2023 SCC OnLine Mad 7690,*** set aside the order of declaring the petitioner's account as fraud account and stated that our order would not preclude the bank from resorting to a proper procedure, in the event it wants to take steps for declaring the petitioners' account as fraud account.

10. The learned counsel for the first respondent would submit that the petitioner Company was given an opportunity before classifying the account of the petitioners Company as Red Flagged Account by the communication dated

15.06.2021. In fact, in the said letter, the subject was mentioned as classifying the account as Red Flagged account and reporting to Reserve Bank of India – M/s Ram Charan Company Private Limited, by referring the letter issued by the second respondent, dated 08.06.2021. Pursuant to the said letter, the second respondent also sent an email dated 25.11.2021. Accordingly, the second respondent decided in the joint lenders meeting dated 12.10.2021 and appointed M/s JC Kabra and Associates, Chartered Accountants to conduct the forensic audit on the petitioner Company. In fact, the petitioner Company was served with a forensic audit report for the period covered from 01.01.2018 to 26.11.2021. Therefore, the petitioner Company was given an opportunity before declaring the petitioners' account as fraud account.

11. The Hon'ble Supreme Court of India categorically held in the case of ***State Bank of India and others Vs Rajesh Agarwal and others*** reported in ***2023 6 SCC 1,*** that an entity against whom evidence is collected must: (i) be provided an opportunity to explain the evidence against it; (ii) be informed of the proposed action, and (iii) be allowed to represent why the proposed action should not be taken. Hence, the mere participation of the borrower during the course of the preparation of a forensic audit report would not fulfil the requirements of natural justice. Hence, the submissions made by the learned

counsel for the first respondent cannot be countenanced.

12. In view of the above Judgment passed by the Hon'ble Supreme Court of India, the impugned circular cannot be sustained and is liable to be quashed. Accordingly, the impugned circular, dated 01.07.2016 (updated as on July 03, 2017), on the file of the first respondent, is hereby quashed. It is open for the respondents to issue notice to the petitioner and its Company to call for explanation and after giving an opportunity of hearing to them, pass fresh orders in the manner known to law.

13. Accordingly, this writ petition stands allowed. Consequently, connected Miscellaneous petitions are closed. There shall be no order as to costs.

10.04.2024
(3/3)

Internet: Yes
Index : Yes/No
Neutral Citation: Yes/No
Speaking/Non Speaking order
mn

G.K.ILANTHIRAIYAN. J,

mn

To

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

2. The Authorized Representatives,
   IDFC First Bank Limited,
   Having its Registered/Branch Office at:
   KRM Tower, 7th Floor,
   No. 1, Harrington Road,
   Chetpet, Chennai – 600 031.

W.P.No.12605 of 2022

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