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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Date of Decision: 29.05.2024

+ W.P.(C) 7971/2024 & CM APPLs. 32912/2024 & 32913/2024

D.D. MOTORS (A UNIT OF DIVISION OF DD INDUSTRIES LTD.) & ORS. Petitioners

Through: Mr. Sanjeev Bhandari with Ms. Anvita Bhandari, Mr. Kunal Mittal, Mr. Charu Sharma, Mr. Arjit Sharma, Mr. Vaibhav Vats, Mr. Anish Chawla and Ms. Aadya Chawla, Advocates.
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versus

HDFC BANK LIMITED

..... Respondent

Through: Mr. Bheem S. Jain, Advocate.

CORAM:
HON'BLE MS. JUSTICE MINI PUSHKARNA
MINI PUSHKARNA, J (ORAL)

CM APPL. 32913/2024 (for exemption)

1. Exemption allowed, subject to just exceptions.
2. Application is disposed of.

W.P.(C) 7971/2024 & CM APPL. 32912/2024

3. The present petition has been filed by the petitioners being aggrieved by the action of the respondent-bank in classifying the account of the petitioners as 'Red Flagged Account' and, subsequently as 'Fraud Account'.
4. Learned counsel appearing for the petitioners submits that the



aforesaid action of the respondent-bank is illegal and invalid in the eyes of law, as the said declaration has been made without following the due process of law, and in violation of the Principles of Natural Justice, as no Show Cause Notice (“SCN”) was ever served upon the petitioners.

5. It is further submitted that the present petition seeks a direction to take steps to remove the name of the petitioners from the Central Fraud Registry. It is submitted that petitioner no. 1 and its Directors were never given any opportunity to present a defence, as no hearing or written reply was ever sought from them. The respondent-bank never invited the petitioner and its Directors to participate in the Forensic Audit. Further, no reasoned order has been passed while declaring the account as ‘*Fraud*’. Thus, it is prayed that the action of the respondent-bank in classifying the account of the petitioners as ‘*Fraud*’, is malafide and, cannot stand the test of the law.

6. It is submitted that the petitioners came to know about declaration of their account as ‘*Fraud*’, when the petitioners approached other banks for the purposes of loan.

7. Learned counsel appearing for the petitioners further submits that full amount, due and payable to the respondent has been paid, and ‘No Dues Certificate’, has also been issued by the respondent, on 12th April, 2023.

8. Learned counsel appearing for the petitioner relies upon Clause 5.2 of the ‘Master Directions on Frauds-Classification and Reporting by Commercial Banks and Select FIs’ (“Master Directions”) issued by the Reserve Bank of India (“RBI”), which reads as under:-

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5.2 Banks should - close only such cases where the actions as stated below are complete and prior approval is obtained from the SSM.



- I. *The fraud cases pending with CBI/Police/Court are finally disposed of.*
 - II. *The examination of staff accountability has been completed.*
 - III. **The amount of fraud has been recovered or written off.**
 - IV. *Insurance claim wherever applicable has been settled.*
 - V. *The bank has reviewed the systems and procedures, identified as the causative factors and plugged the lacunae and the fact of which has been certified by the appropriate authority (Board/Audit Committee of the Board)*
- xxx xxx xxx”

(Emphasis Supplied)

9. Issue notice.
10. Notice is accepted by learned counsel appearing for the respondent bank.
11. He submits that the declaration of the account of the petitioners as ‘*Fraud*’, was done prior to the judgment in the case of ***State Bank of India and Others Versus Rajesh Agarwal and Others, 2023 SCC OnLine SC 342***. He, thus, submits that the action was taken by the respondent-bank, in terms of the law that was prevalent at that point of time.
12. Further, learned counsel appearing for the respondent concedes to the fact that ‘No Dues Certificate’, has already been issued by the respondent-bank to the petitioner, as full amount, has already been paid by the petitioner to the respondent-bank.
13. Having heard learned counsels for the parties and after perusing the record, this Court at the outset notes that in the present case, declaration of ‘*Fraud*’, has been done without issuance of any SCN or providing any opportunity of representation to the petitioners, against declaration of the account of the petitioners as ‘*Fraud*’.



14. The Hon'ble Supreme Court in the case of ***Rajesh Agarwal (supra)*** has categorically held that Principles of Natural Justice have to be necessarily read into the Master Directions on Fraud, to save it from the vice of arbitrariness. Thus, the Hon'ble Supreme Court has held as follows:-

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67. **The Master Directions on Frauds do not expressly exclude a right of hearing to the borrowers before action to class their account as frauds is initiated. The principles of natural justice can be read into a statute or a notification where it is silent on granting an opportunity of a hearing to a party whose rights and interests are likely to be affected by the orders that may be passed.**

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70. In *Mangilal v. State of M.P.* [*Mangilal v. State of M.P.*, (2004) 2 SCC 447 : 2004 SCC (Cri) 1085] , a two-Judge Bench of this Court held that the principles of natural justice need to be observed even if the statute is silent in that regard. In other words, a statutory silence should be taken to imply the need to observe the principles of natural justice where substantial rights of parties are affected : (SCC pp. 453-54, para 10)

“10. Even if a statute is silent and there are no positive words in the Act or the Rules made thereunder, there could be nothing wrong in spelling out the need to hear the parties whose rights and interest are likely to be affected by the orders that may be passed, and making it a requirement to follow a fair procedure before taking a decision, unless the statute provides otherwise. The principles of natural justice must be read into unoccupied interstices of the statute, unless there is a clear mandate to the contrary. No form or procedure should ever be permitted to exclude the presentation of a litigant's defence or stand. Even in the absence of a provision in procedural laws, power inheres in every tribunal/court of a judicial or quasi-judicial character, to adopt modalities necessary to achieve requirements of natural justice and fair play to ensure better and proper discharge of their duties. Procedure is mainly grounded on the principles of natural justice irrespective of the extent of its application by express provision in that regard in a given situation. It has always been a cherished



principle. Where the statute is silent about the observance of the principles of natural justice, such statutory silence is taken to imply compliance with the principles of natural justice where substantial rights of parties are considerably affected. **The application of natural justice becomes presumptive, unless found excluded by express words of statute or necessary intendment.** ... Its aim is to secure justice or to prevent miscarriage of justice. Principles of natural justice do not supplant the law, but supplement it. These rules operate only in areas not covered by any law validly made. They are a means to an end and not an end in themselves.

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75. As mentioned above, Clause 8.9.6 of the Master Directions on Frauds contemplates that the procedure for the classification of an account as fraud has to be completed within six months. The procedure adopted under the Master Directions on Frauds provides enough time to the banks to deliberate before classifying an account as fraud. During this interval, the banks can serve a notice to the borrowers, and give them an opportunity to submit their reply and representation regarding the findings of the forensic audit report. Given the wide time-frames contemplated under the Master Directions on Frauds as well as the nature of the procedure adopted, it is reasonably practicable for banks to provide an adequate opportunity of a hearing to the borrowers before classifying their account as fraud.

76. The exclusion contemplated in the decision of this Court in *Tulsiram Patel [Union of India v. Tulsiram Patel, (1985) 3 SCC 398 : 1985 SCC (L&S) 672]* would not be applicable because giving an opportunity of a hearing to the borrowers will not obstruct the taking of prompt action under the Master Directions on Frauds.

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79. In *Swadeshi Cotton Mills [Swadeshi Cotton Mills v. Union of India, (1981) 1 SCC 664]*, this Court held that **a company is entitled to an opportunity to explain the evidence collected against it and represent why the proposed action should not be taken** : (SCC p. 707, para 85)

“85. The contention does not appear to be well founded. Firstly, this documentary evidence, at best, shows that the Company was in debt and the assets of some of its “units” had been hypothecated or mortgaged as security for those debts. Given an



opportunity the Company might have explained that as a result of this indebtedness there was no likelihood of fall in production, which is one of the essential conditions in regard to which the Government must be satisfied before taking action under Section 18-AA(1)(a). Secondly, what the rule of natural justice required in the circumstances of this case, was not only that the Company should have been given an opportunity to explain the evidence against it, but also an opportunity to be informed of the proposed action of take over and to represent why it be not taken.”

80. Audi alteram partem has several facets, including the service of a notice to any person against whom a prejudicial order may be passed and providing an opportunity to explain the evidence collected. In *Tulsiram Patel [Union of India v. Tulsiram Patel, (1985) 3 SCC 398 : 1985 SCC (L&S) 672]*, this Court explained the wide amplitude of audi alteram partem : (SCC p. 476, para 96)

“96. The rule of natural justice with which we are concerned in these appeals and writ petitions, namely, the audi alteram partem rule, in its fullest amplitude means that a person against whom an order to his prejudice may be passed should be informed of the allegations and charges against him, be given an opportunity of submitting his explanation thereto, have the right to know the evidence, both oral or documentary, by which the matter is proposed to be decided against him, and to inspect the documents which are relied upon for the purpose of being used against him, to have the witnesses who are to give evidence against him examined in his presence and have the right to cross-examine them, and to lead his own evidence, both oral and documentary, in his defence. The process of a fair hearing need not, however, conform to the judicial process in a court of law, because judicial adjudication of causes involves a number of technical rules of procedure and evidence which are unnecessary and not required for the purpose of a fair hearing within the meaning of audi alteram partem rule in a quasi-judicial or administrative inquiry.”

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.**

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87. Administrative proceedings which entail significant civil consequences must be read consistent with the principles of natural justice to meet the requirement of Article 14. Where possible, the rule of audi alteram partem ought to be read into a statutory rule to render it compliant with the principles of equality and non-arbitrariness envisaged under Article 14. The Master Directions on Frauds do not expressly provide the borrowers an opportunity of being heard before classifying the borrower's account as fraud. Audi alteram partem must then be read into the provisions of the Master Directions on Frauds.

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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 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 [Shree Saraiwwalaa Agrar Refineries Ltd. v. Union of India, 2022 SCC OnLine SC 1905] 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.

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98. The conclusions are summarised below:

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

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

98.3. 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.

98.4. 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.

98.5. 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.

98.6. 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.

98.7. 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.

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(Emphasis Supplied)

15. Considering the issue of applicability of the judgment of **Rajesh**



Agarwal (supra), in cases, where the declaration of the account as 'Fraud', was prior to the aforesaid judgment, a Coordinate Bench of this Court in the case of *Religare Finvest Limited Versus State Bank of India*, 2023 SCC OnLine Del 8587, has held as follows:-

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4. He also submits that the principle of law laid down in the case of State Bank of India v. Rajesh Agarwal would not have any application as the said decision has been rendered by the Hon'ble Supreme Court on 27.03.2023, whereas, the impugned decision was taken prior to the pronouncement of the decision by the Hon'ble Supreme Court.

5. The parties also submit that the account of the petitioner has been settled and no due certificate has also been issued to the respondent.

6. I have considered the submissions made on behalf of the learned counsel appearing on behalf of the parties and perused the record.

7. Similar objection with respect to prospective applicability of the decision in the case of *Rajesh Agarwal (supra)* has been considered by this court in W.P.(C) 9302/2022. The relevant paragraphs of W.P.(C) 9302/2022 read as under:

“7. A perusal of the entire counter affidavit would not even remotely suggest that the principles of natural justice have been followed in the instant case. It is the respondent-Bank's contention that the decision of Rajesh Aggarwal (supra) will not have application in the instant case. However, a careful scrutiny of Rajesh Aggarwal (supra) reveals that the Hon'ble Supreme Court has clarified that the RBI Master Circular bearing No. DBS.CO. CFMC.BC. No. 1/23.04.001/2016-17 dated 01.07.2016 should adhere to the Principles of Natural Justice.

8. It is also to be noted that the Hon'ble Supreme Court in *Asstt. Commissioner v. Saurashtra Kutch Stock Exchange*, (2008) 14 SCC 171, held as under that:

“35. In our judgment, it is also well settled that a judicial decision acts retrospectively. According to Blackstonian theory, it is not the function of the court to pronounce a “new rule” but to maintain



and expound the “old one”. In other words, Judges do not make law, they only discover or find the correct law. The law has always been the same. If a subsequent decision alters the earlier one, it (the later decision) does not make new law. It only discovers the correct principle of law which has to be applied retrospectively. To put it differently, even where an earlier decision of the court operated for quite some time, the decision rendered later on would have retrospective effect clarifying the legal position which was earlier not correctly understood.

36. Salmond in his well-known work states: “The theory of case law is that a judge does not make law; he merely declares it; and the overruling of a previous decision is a declaration that the supposed rule never was law. Hence any intermediate transactions made on the strength of the supposed rule are governed by the law established in the overruling decision. The overruling is retrospective, except as regards matters that are *res judicatae* or accounts that have been settled in the meantime.”

37. It is no doubt true that after a historic decision in *Golak Nath v. State of Punjab*, (1967) 2 SCR 762 this Court has accepted the doctrine of “prospective overruling”. It is based on the philosophy: “The past cannot always be erased by a new judicial declaration.” It may, however, be stated that this is an exception to the general rule of the doctrine of precedent.”

9. In view of the abovementioned legal position, it is clear that the effect of *Rajesh Aggarwal (supra)* will have full application in the instant case as it does not alter the scope of *RBI Master Circular bearing No. DBS.CO. CFMC.BC. No. 1/23.04.001/2016-17 dated 01.07.2016*, rather it interprets the circular in tune with the intention behind it and included Principles of Natural Justice in the implementation of the circular. Thus, this Court finds no merit in the respondent-Bank's contention. Irrespective of the fact whether the decision is taken post *Rajesh Aggarwal (supra)* or pre *Rajesh Aggarwal (supra)*, the principles enshrined in *Rajesh Aggarwal (supra)* will



have full application in the instant case.”

8. *It is thus seen that in view of the principles laid down in the case of Rajesh Agarwal (supra), the impugned action of the respondent deserves to be set aside.*

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(Emphasis Supplied)

16. Thus, it is manifest that in the absence of issuance of any SCN to the petitioners, and without granting any opportunity to them, to represent their defence against classifying their accounts as ‘*Fraud*’, declaration of the account of the petitioners as ‘*Fraud*’, is patently illegal. The said declaration has been done without following the due process of law, and is in violation of the Principles of Natural Justice. The said Principles, as encapsulated in the judgment of ***Rajesh Agarwal (supra)***, would be applicable to the present case, irrespective of the fact whether the decision by the respondent-bank for declaration of the account of the petitioners as ‘*Fraud*’, is taken pre or post the judgment in the case of ***Rajesh Agarwal (supra)***.

17. Considering the aforesaid detailed discussion, placing/notifying the account of the petitioners as ‘*Red Flagged*’ vide order dated 31st December, 2020, and declaration of the account of the petitioners as ‘*Fraud*’, vide order dated 30th June, 2021, is hereby quashed. Consequently, any other ancillary proceedings, which have been initiated by the respondent-bank, shall also stand quashed.

18. Accordingly, directions are issued to the respondent-bank to communicate to the ‘Central Fraud Registry’ constituted under the Master Directions issued by the RBI, to delete the name of the petitioners, from their website.



19. The present petition is disposed of, along with pending applications, in view of the aforesaid detailed discussion.

MINI PUSHKARNA, J

MAY 29, 2024

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