IN THE HIGH COURT AT CALCUTTA

Civil Appellate Jurisdiction

Original Side

Present:
The Hon'ble Justice Debangsu Basak
And
The Hon'ble Justice Prasenjit Biswas

APOT 390 of 2024
With
IA GA 2 of 2024
Harish Kumar Agarwal & Ors.
Vs.
Axis Bank & Anr.

For Appellants	: Ms. Noelle Banerjee, Adv. Mr. Arkadeb Sinha. Adv. Mr. Mainak Biswas, Adv. Ms. Simran More, Adv.
For the Private Respondent	: Mr. Pourush Bandyopadhyay Adv. Mr. S. Ganguly , Adv.
For Private Respondent No. 1 (Axis Bank)	: Mr. Souradeep Banerjee. Adv. Mr. Abhidipto Tarafdar, Adv. Mr. S.K.Banerjee, Adv. Ms. Sanjana Sinha, Adv.
Hearing Concluded on	: August 05, 2025
Judgment on	: August 21, 2025

DEBANGSU BASAK, J.:-

1. Appellants have assailed the order dated August 20, 2024 passed by the learned Single Judge in WPO 630 of 2024.

2. By the impugned order, learned Single Judge has dismissed the writ petition of the appellants.

3. Appellants had filed a writ petition assailing the show cause notice dated December 8, 2023 and the order dated May 2, 2024 issued by the bank declaring the accounts of the appellants as fraud.

4. Learned advocate appearing for the appellants has submitted that, Reserve Bank of India issued Reserve Bank of India (Frauds Classification and Reporting by Commercial Banks and select FIs) Directions, 2016. She has submitted that, Supreme Court, in ***2023 Volume 6 Supreme Court Cases 1 (State Bank of India and Others versus Rajesh Agarwal and Others)*** held that, the Directions of 2016 are binding upon the bank. She has submitted that, Supreme Court held that, a bank is obliged to afford an opportunity of hearing to the borrower prior to classifying the account as a fraud, in terms of the Directions of 2016. She has contended that, in the facts and circumstances of the present case, bank did not afford the borrower or the appellants, any opportunity of hearing prior to deciding to classify the accounts of the borrower, as frauds, within the meaning of the Directions of 2016. Consequently, according to her, the impugned decision of the bank dated May 2, 2024 classifying account of the borrower, as fraud, has to be set aside being passed in breach of the principles of natural justice.

5. Elaborating on the issue of breach of principles of natural justice, learned advocate appearing for the appellants has submitted that, a notice dated December 8, 2023 purporting to be a show cause notice under the Directions of 2016 was issued to the appellants. She has drawn the attention of the Court to the person issuing such notice. She has contended that, such person is not the authority, contemplated under the Directions of 2016, to issue a show cause notice. She has drawn the attention of the Court to the reply dated December 22, 2023 given by the borrowers, to the show cause notice. She has submitted that, the reply of the borrower was not considered by the designated authority under the Directions of 2016. She has drawn the attention of the Court to the so-called decision of the bank to classify the account of the borrower as fraud within the meaning of the Directions of 2016 dated May 2, 2024. She has submitted that, again, the designated authority under the Directions of 2016 did not issue the letter dated May 2, 2024.

6. Learned advocate appearing for the appellants has drawn the attention of the Court to the provisions of the Directions of 2016. She has submitted that, in terms of Chapter II clause 2.1.2 fraud, fraud monitoring and fraud investigation function must be owned by the Chief Executive Officer of the Bank, Audit Committee of the Board and the Special Committee of the Board. She has contended that, neither the authority issuing the show cause notice nor the authority which decided on the show cause notice as well as the reply thereto, falls within the categories of authorities described in clause 2.1.2 of the Directions of 2016, empowered to decide on the issue of fraud. Consequently, not only the decision dated May 2, 2024 but also, the show cause notice are bad in law and must be squashed.

7. In support of the contention that, the authorities mentioned in clause 2.1.2 of the Directions of 2016 are the only authorities entitled to issue a show cause notice and decide thereon, learned advocate appearing for the appellants has relied upon ***2023 SCC Online Cal 2643 (Prashant Bothra and Another versus Bureau of Immigration and Others)***, ***2024 SCC Online Cal 4261 (Ridhi Sidhi Cold Storage Private Ltd and Others versus Punjab National Bank and Another)*** and ***2024 SCC Online Cal 4756 (Amit Kumar Kejriwal versus UCO Bank and Others)***.

8. Learned advocate appearing for the bank has submitted that, the bank all along acted in terms of the Directions of 2016. Bank after identifying that there were materials to suggest that, the borrower acted fraudulently, issued show cause notice to the appellants, by the letter dated December 8, 2023. Bank had considered the reply dated December 22, 2023 of the appellants. Bank had communicated the decision dated May 2, 2014 to the appellants.

9. Appellants are directors of Supreme & Co. Private Limited which had obtained credit facilities aggregating to Rs. 202.65 crores from a consortium of banks including Axis Bank. Additionally, such company had availed of credit facilities aggregating Rs. 280.26 crores from 3 other banks and Rs. 18.75 crores from another bank and a financial institution under multiple banking arrangements.

10. Account of the borrower vis a vis the Axis Bank had been classified as a Non-Performing Asset (NPA) on December 29, 2022. Axis Bank had recalled the credit facilities on March 13, 2023. It had issued a notice under Section 13 (2) of the Securitisation and Reconstruction of Financial Assets and Security Interest Act, 2002 on November 17, 2023. Axis Bank had also filed proceedings before the Debts Recovery Tribunal for recovery of the debt. Axis Bank had classified the borrower as a Red Flag Account (RFA) within the meaning of the Directions of 2016 on July 26, 2023 based upon the Early Warning System (EWS) as lead banker of the consortium classified the borrower as RFA.

11. Axis Bank had undertaken a forensic audit of the account of the borrower. Axis Bank had taken into consideration the Forensic Audit Report. It had noted that, although, the borrower reported a total inventory of Rs. 235 crores, members of the bank officials were not allowed to verify the stock physically. It had noted instances of diversification of funds as well as other misdeeds. Forensic auditor had concluded that the account was a fraud.

12. Axis Bank had issued a show cause notice to the borrower on December 8, 2023 seeking explanation on the adverse findings of the forensic audit report. Borrower had submitted a response dated December 22, 2023. .

13. Axis Bank had afforded personal hearing to the borrower. Some of the appellants had appeared in such personal hearing held on February 26, 2024. The forensic report as also the reply to the show cause notice had been discussed at length. Bank had prepared a minutes of such hearing. The Fraud Identification Council of Axis Bank had decided that the account is required to be classified as a fraud within the meaning of the Directions of 2016. Such Council had arrived at such decision on the basis of the adverse findings of the forensic audit report.

14. By the impugned writing dated May 2, 2014, Axis Bank had communicated the decision of the Fraud Identification Council to the borrower and the appellants. Being aggrieved, the appellants had filed the writ petition which has resulted in the impugned order.

15. Reserve Bank of India has issued the Directions of 2016 under Section 35A of the Banking Regulation Act, 1949. The Directions of 2016 are divided into 11 chapters with 3 annexures therein. As clause 1.3 of the Directions of 2016 would demonstrate, such directions were issued with a view to providing a framework to banks enabling them to detect and report frauds early and taking timely consequent action like reporting to the Investigative Agencies so that fraudsters are brought to book early, examining staff accountability and do effective fraud risk management.

16. The Directions of 2016 have provided various mechanisms to facilitate early detection and reporting of frauds. Under clause 2.1 it has vested the responsibility of fraud risk management, fraud monitoring and fraud investigation function with the Chief Executive officer of the bank, Audit Committee of the Board and the Special Committee of the Board. It has required the banks to frame internal policy for fraud risk management and fraud investigation function, based on the governance standard relating to the ownership of the function and accountability. It has required banks to nominate an official of the rank of the General Manager to be responsible for submitting all returns with the Reserve Bank of India in this regard.

17. Clause 4.4 the Directions of 2016 has required the banks to constitute a Special Committee of the Board for monitoring and follow-up of the cases of fraud involving amounts of Rs. 10 million and above exclusively. It has noted that, while Audit Committee of the Board shall monitor all cases of the frauds in general, the Special Committee of the Board shall monitor cases of fraud of specified value.

18. While the Directions of 2016 have classified frauds into various categories as enumerated in clause 2.2.1 thereof, it has dealt with loan frauds in particular under Chapter VIII. Clause 8.3 has dealt with Early Warning Signals and Red Flag Accounts. Clause 8.3.5 has laid down that, the officer responsible for the operation of the account, by whatever designation called, should be sensitised to observe and report any manifestation of the Early Warning Signals promptly to the Fraud Monitoring Group or any other group constituted by the bank for such purpose, immediately. It has also laid down that, in order to ensure that the exercise remains meaningful, such officer may be held responsible for nonreporting or delay in reporting.

19. Classification of the account as a Red Flag Account in terms of the Directions of 2016 has been vested with the Fraud Monitoring Group or any other group constituted by the bank, for such purpose, under clause 8.3.6 thereof. Clause 8.3.7 has provided that, a report on the Red Flag Account shall be put up to the Special Committee of the Board for monitoring and follow-up of frauds.

20. The mechanism for detection of fraud and classifying an account as Red Flag Account that has been introduced by the Directions of 2016 may be summarised as follows: –

(i) officer responsible for operation in the account will report any manifestation of the Early Warning System promptly to the Fraud Monitoring Group (see clause 8.3.5);

(ii) Fraud Monitoring Group or any such designated committee shall classify the account as Red Flag Account and the details of the Red Flag Account shall be put up to the Chairman and Managing Director/Chief Executive Officer every month (see clause 8.3.6);

(iii) a report on the Red Flag Account shall be put up to the Special Committee of the Board for monitoring and follow-up of frauds (see clause 8.3.7);

(iv) fraud risk management, fraud monitoring and fraud investigation function shall be the responsibility of the Chief Executive Officer of the bank, Audit Committee of the Board and the Special Committee of the Board (see clause 2.1.2);

(v) bank shall specifically nominate an official of the rank of the General Manager who will be responsible for submitting all returns referred to under the Directions of 2016 to the Reserve Bank of India (see clause 2.1.4).

(vi) Banks are required to lodge complaint with law enforcement agencies immediately on detention of fraud (see clause 8.11.1)

21. Therefore, under the hierarchy as created by the Directions of 2016, the bank official responsible for the operations of the bank account initially is obliged to detect any fraud in the bank account and report the manifestation of Early Warning Signal promptly to the Fraud Monitoring Group of the bank. Once such bank official reports to the Fraud Monitoring Group of the Early Warning Signal of the accounts, the Fraud Monitoring Group decides the issue as to whether, the account needs to be classified as a Red Flag Account or not.

22. The issue as to whether, a bank is required to afford an opportunity of hearing to the borrower, while deciding to classify the account as a Red Flag Account in terms of the Directions of 2016 has been decided in ***Rajesh Agarwal (supra)***. It has held that, principles of natural justice must be read into the Directions of 2016 to the extent where such Directions of 2016 imposes civil liability on a borrower.

23. ***Rajesh Agarwal (supra)*** has noted that, fraud in a transaction may result both in civil and in criminal liability. It has noted that, the Directions of 2016 also require reporting of fraud to the investigating agencies. It has held that, a borrower has no right of audience when, a first information report is lodged or registered with any investigating agency with regard to the fraud involved in the bank account concerned.

24. ***Prashant Bothra (supra)*** has dealt with the issuance of Lookout Circulars as against the writ petitioners by a bank and the Serious Fraud Investigation Office. In the context of a Lookout Notice issued by a bank acting in terms of relevant circulars and the Serious Fraud Investigation Office under the provisions of the Companies Act, 2013 it has observed that, a forensic audit report is not conclusive proof of the allegations against the borrower. In the facts and circumstances of the present case, the parties before us are governed by the Directions of 2016 and the action taken by the bank are in discharge of duties vested in it under the Directions of 2016 are under consideration. The facts and circumstances of the present case are therefore different to those obtaining in ***Prashant Bothra (supra)***.

25. ***Ridhi Sidhi Cold Storage Private Limited and others (supra)*** has considered the Directions of 2016 limiting itself to clause 4.4.1 thereof. Apparently, attention of the Court was not drawn to the other clauses of the Directions of 2016. With the deepest of respect, it has not considered the hierarchy established by the Directions of 2016 in detecting a fraud in an account, reporting it to a committee (Fraud Monitoring Committee) for deciding to classify such account as a Red Flag Account and the ultimate monitoring of fraud risk management and investigation being vested with the Chief Executive Officer of a bank. It has overlooked clauses 8.3.5 and 8.3.6 of the Directions of 2016 which specifically require the Fraud Monitoring Group to classify the account as Red Flag Account and to put up the report with regard thereto to the concerned CMD/CEO every month.

26. ***Amit Kumar Kejriwal (supra)*** has considered a show cause notice issued under the Directions of 2016 by the zonal head of the bank. It has held that, in view of clause 4.4.1 of the Directions of 2016 scope of functioning of the Special Committee would also include proceedings taken under the Directions of 2016 for declaring an account or an entity as fraud. Consequently, since, the show cause notice was not issued by the Special Committee the same was set aside.

27. With the deepest of respect, provisions of clauses 8.3.5 and 8.3.6 of the Directions of 2016 were not drawn to the attention of the Court rendering ***Amit Kumar Kejriwal (supra)***. Clauses 8.3.5 and 8.3.6 of the Directions of 2016 have obliged a bank to constitute a Fraud Monitoring Group by any name it chooses to call it, for the purpose of deciding the issue as to whether or not to classify any account as a Red Flag Account. The Directions of 2016 have recognized the Special Committee under clause 4.4.1 to be an authority for the purpose of monitoring and follow-up of cases of frauds of a particular value. The value specified for the Special Committee is Rs. 10 million. Therefore, all accounts which are required to be classified as Red Flag Account cannot be considered by the Special Committee as sought to be held in ***Amit Kumar Kejriwal (supra)***.

28. In the facts and circumstances of the present case, bank has acted in terms of the Directions of 2016. It has issued a show cause notice on December 18, 2023 to the borrower. Such show cause notice has been issued by the authorised signatory of the bank. The Directions of 2016 do not require the Fraud Monitoring Group to issue the show cause notice. Show cause notice can be issued by the bank, at any level in order to put the borrower notice that, the issue of classifying the account as Red Flag Account in terms of the Directions of 2016 will be considered by the Fraud Monitoring Group set up under the Directions of 2016. Moreover, the appellants have not established any prejudice being caused to them by the show cause notice being issued by the authorised signatory of the Bank.

29. In the facts and circumstances of the present case, borrower has replied to the show cause notice by a letter dated December 22, 2023. Borrower being represented by some of the appellants have appeared before the Fraud Monitoring Group of the bank on diverse dates of hearing. The Directions of 2016 has allowed the banks to call Fraud Monitoring Group by any other name. In this case, Axis bank has named the Fraud Monitoring Group established under the Directions of 2016 as Fraud Identification Council.

30. Bank has shared the forensic report with the borrower. At the hearing before the Fraud Identification Council, the contents of the forensic audit report has been discussed both by the bank as well as by the borrower and the appellants. After considering such materials, Fraud Identification Council has found the contents of the forensic audit report to be acceptable and proceeded to classify the account of the borrower as Red Flag Account in terms of the Directions of 2016. Bank has communicated this decision of the Fraud Identification Council to the borrower and the appellants by the letter dated May 2, 2024.

31. Bank has therefore compiled with the principles of natural justice in arriving at the decision as communicated by the letter dated May 2, 2024. Bank has permitted the borrower and the appellants to reply to the show cause notice, heard them and passed a reasoned order. The decision taken by the Fraud Identification Council of Axis bank has not been established to be perverse or made in colourable exercise of power or arbitrary or in excess of jurisdiction. The view taken by the Fraud Identification Council is plausible.

32. In view of the discussions above, we find no merits in the instant appeal.

33. APOT 390 of 2024 along with IA GA 2 of 2024 are dismissed without any orders to cost.

[DEBANGSU BASAK, J.]

34. I agree.

[PRASENJIT BISWAS, J.]