



IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 24.03.2025

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CORAM:

THE HONOURABLE MR. JUSTICE D.BHARATHA CHAKRAVARTHY

W.P.No.10002 of 2025

and

WMP.No.11212 of 2025

1.M/s.Nandhi Dall Mills
Registered Firm, represented by its Partners
No.270, Narasimman Road
Shevapet
Salem 636 002.

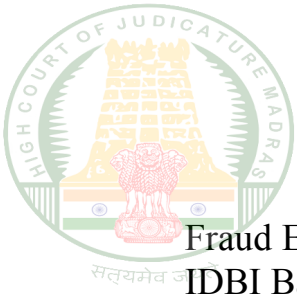
2.Tmt.K.Jayanthi, Partner of D-1 Firm
No.270, Narasimman Road
Shevapet
Salem 636 002.

3.Mr.K.Arun, Partner of D-1 Firm
No.270, Narasimman Road
Shevapet
Salem 636 002.

4.M/s.Shir Nandhi Dall Mills India Pvt Ltd.,
Represented by its Managing Director
No.270, Narasimman Road
Shevapet
Salem 636 002.

...Petitioners

Vs.



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Fraud Examination Committee (FEC)-II

IDBI Bank Limited

IDBI Tower, WTC Complex

Cuffe Parade

Mumbai 400 005.

....Respondent

Prayer : Writ Petition filed under Article 226 of the Constitution of India, to issue a Writ of Certiorari, seeking to call for the records pertaining to its letter dated 17.02.2025, issued by the respondent and to quash the same as being illegal, prejudicial, and ultra vires to the RBI's Circular dated 15.07.2024.

For Petitioners : M/s.K.R.Ananda Gomathy

For Respondents : Mr.V.Suresh
for Mr.Shivakumar & Suresh
IDBI Bank

ORDER

This Writ Petition is filed to call for the records pertaining to the communication dated 17.02.2025 issued by the respondent and to quash the same.



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2. Heard *M/s.K.R.Ananda Gomathy*, the learned counsel appearing on behalf of the petitioners and *Mr.Shivakumar*, the learned counsel appearing on behalf of the respondent Bank.

3. The learned counsel for the petitioners taking this Court through the show cause notice would contend that in this case the allegation is made only because a sister concern was permitted to use the same premises. The same does not in any manner would amount to fraud. When the show cause notice was received, a legal notice was issued seeking for particulars including whether any special audit that is done. Without furnishing the said particulars and grant of proper opportunity to the petitioners straight away the account has been declared as fraudulent, aggrieved by which, the petitioners are before this Court. The learned counsel would submit that firstly, as per the Clause 2.1.3 of the circular belonging to the Reserve Bank of India dated 15.07.2024 that governs the issue, a Committee should have been constituted with at least two independent



Directors.

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4. A perusal of the impugned order would reveal that there are no such independent Directors involved in the entire exercise. Secondly, the learned counsel would submit that as per Chapter IV Clause 4, the Credit Facility/Loan Account classified as Red-flagged Account is to be audited either by using an external audit or an internal audit as per the Board approved policy. In spite of a specific stand taken in the legal notice the respondents have not mentioned about any external audit or a special internal audit that is being done.

5. As a matter of fact, even the impugned order does not speak of any internal or external audit and it is passed merely on their presumption and assumptions. A mere utilization of the premises of the petitioner by yet another sister concern by itself would not amount to fraud and that is why the bank, without even undertaking any proper audit, had issued the order. As a matter of fact, even on the earlier occasion with reference to the classifying



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the account as a willful defaulter, the bank indulged in exercises and published the photographs and one of the partners also passed away unable to bear the pressure. Therefore, in this case, the action of the bank is unfair. Out of the Rs.32 Crores loan that is availed, already Rs.18 Crores have been repaid. Therefore, this Court should interfere in the impugned order.

6. Per Contra, *Mr.Shivakumar*, the learned counsel appearing on behalf of the Respondent bank would submit that as far as the earlier round relating to willful default is concerned, the action was challenged by way of WP.No.31299 of 2023 and only after the Court ordered notice and no interim order was granted, the publication was made and further proceedings were undertaken. As as far as the present exercise of power is concerned, the learned counsel would submit that when the entire facility belongs to the petitioner herein and the machineries were all hypothecated to the bank, instead of carrying out the transaction in the name of the petitioner, another corporate entity was floated by the same partners and the corporate entity was doing the very same business using the very same brand and the machinery of the petitioner herein. Therefore, on the face of it, the actions of the petitioner



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amount to fraud.

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7. As far as the procedures laid down by the RBI is concerned, he would submit that the procedure for classification as fraud, is laid down in Clause 2.1 and Clause 2.1.3 relates only for monitoring and following up. Therefore for taking action there need not be any committee with independent members. As far as the other allegation is concerned, the learned counsel would submit that due show cause notice has been given and the issue has been decided.

8. I have considered the rival submissions made on either side and perused the material records of the case.

9. The Court cannot go into the details of the various allegations that are made against the petitioner and the subjective satisfaction of the same. This Court will only consider whether the allegations *prima facie* point out towards fraud or not. When it is the allegation of the respondent bank that when the business under the Nandhi brand was carried on by the partnership



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firm by availing loan from the bank and when the entire place was mortgaged and the machineries were hypothecated in favour of the Bank then shifting of the business in the name of a corporate entity by using the same premises and the same machinery is the allegation that is made by the bank and as such, I am not in a position to accept the contention of the learned counsel for the petitioner that the allegations will not constitute fraud at all. The next question which has to be considered by this Court is that whether the classification is made as per the circular or not. In this case, a show cause notice has been given and the opportunity has been given. The two other contentions that are made are that firstly, there must be a committee as contemplated under Clause 2.1.3 of the Reserve Bank of India circular for classifying the account as a fraud.

10. The Clause 2.1 and 2.2 in entirety are extracted hereunder for ready reference:

“2.1 Governance Structure in banks for Fraud Risk Management

2.1.1 There shall be a Board approved Policy on fraud risk management delineating roles and responsibilities of Board / Board Committees and Senior Management of the bank. The Policy shall also incorporate measures for



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ensuring compliance with principles of natural justice in a time-bound manner which at a minimum shall include:

2.1.1.1 Issuance of a detailed Show Cause Notice (SCN) to the Persons, Entities and its Promoters / Whole-time and Executive Directors against whom allegation of fraud is being examined. The SCN shall provide complete details of transactions / actions / events basis which declaration and reporting of a fraud is being contemplated under these Directions.

2.1.1.2 A reasonable time of not less than 21 days shall be provided to the Persons / Entities on whom the SCN was served to respond to the said SCN.

2.1.1.3. Banks shall have a well laid out system for issuance of SCN and examination of the responses / submissions made by the Persons /Entities prior to declaring such Persons/Entities as fraudulent.

2.1.1.4 A reasoned Order shall be served on the Persons / Entities conveying the decision of the bank regarding declaration/classification of the account as fraud or otherwise. Such Order(s) must contain relevant facts/circumstances relied upon, the submission made against the SCN and the reasons for classification as fraud or otherwise.

2.1.2 The Fraud Risk Management Policy shall be reviewed by the Board at least once in three years, or more frequently, as may be prescribed by the Board.

2.1.3 Special Committee of the Board for



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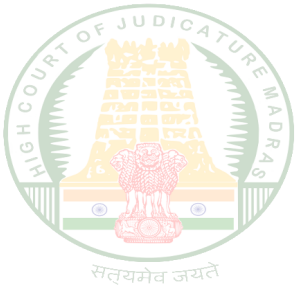
Monitoring and Follow-up of cases of Frauds:

2.1.3.1 Banks shall constitute a Committee of the Board to be known as 'Special Committee of the Board for Monitoring and Follow-up of cases of Frauds' (SCBMF) with a minimum of three members of the Board, consisting of a whole-time director and a minimum of two independent directors/non-executive directors. The Committee shall be headed by one of the independent directors/non-executive directors.

2.1.3.2 SCBMF shall oversee the effectiveness of the fraud risk management in the bank. SCBMF shall review and monitor cases of frauds, including root cause analysis, and suggest mitigating measures for strengthening the internal controls, risk management framework and minimising the incidence of frauds. The coverage and periodicity of such reviews shall be decided by the Board of the bank.

2.1.4 The Senior Management shall be responsible for implementation of the fraud risk management policy approved by the Board of the bank. A periodic review of incidents of fraud shall also be placed before Board/Audit Committee of Board (ACB), as appropriate, by the Senior Management of the bank.

2.1.5 Banks shall put in place a transparent mechanism to ensure that Whist Blower complaints on possible fraud cases/suspicious activities in account are examined and concluded appropriately under their Whistle Blower Policy.



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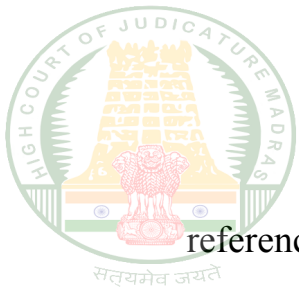
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2.2 Banks shall set-up an appropriate organisational structure for institutionalisation of fraud risk management within their overall risk management functions / Department A senior official in the rank of at least a General Manager or equivalent shall be responsible for monitoring and reporting of frauds.”

11. As pointed out by the learned counsel for the bank, it can be seen that the governance structures for fraud risk management is spelt out in Clause No.2.1.1 and it is only for monitoring and follow up cases, Clause 2.1.3 would apply. Therefore, I am unable to accept the contention of learned counsel for the petitioner that there must be necessarily two independent Directors even for classification of the account as fraudulent.

12. The further ground that is argued by *M/s.K.R.Anand Gomathi*, the learned counsel for the petitioner is that as per Chapter IV, Clause 4.1, there should have been an external audit or an internal audit. It can be seen that Chapter IV is with reference to the auditing of the credit facility/loan account classified as a Red Account.

13. The entire Clause 4 is extracted hereunder for ready



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reference;

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“4. Credit facility / Loan account classified as Red-flagged Account and Reporting of Fraud

4.1 In case of a credit facility / loan account classified as red-flagged account, banks shall use an external audit¹ or an internal audit as per their Board approved Policy, for further investigation in such accounts.

4.1.1 Banks shall frame a policy on engagement of external auditors covering aspects such as due diligence, competency and track record of the auditors, among others. Further, the contractual agreement with the auditors shall, inter alia, contain suitable clauses on timeline for completion of the audit and submission of audit report to the bank within a specified time limit, as approved by the Board.

4.1.2 The loan agreement with the borrower shall contain clauses for conduct of such audit at the behest of lender(s) consequent upon red flagging of the account. In cases where the audit report submitted remains inconclusive or is delayed due to non-cooperation by the borrower, banks shall conclude on status of the account as a fraud or otherwise based on the material available on their record and their own internal investigation / assessment in such cases¹⁵.

4.1.3 The decision to classify any account, either standard or NPA, as a red-flagged account shall be at the individual bank level and such bank(s) shall report the status of the account on the Reserve Bank's



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CRILC platforms immediately (not later than seven days from date of classification as red-flagged account).

4.1.4 The bank (in case of sole lending) or the individual banks (in case of multiple banking arrangement or consortium lending) shall ensure that the principles of natural justice" are strictly adhered to before classifying/declaring an account as fraud.

4.1.5 Once an account has been red-flagged, the entire process of classification of the account as fraud or removal of red-flagged status shall ordinarily be completed within 180 days from the date of first reporting of the account as red-flagged on the CRILC platform. Cases remaining in red-flagged status beyond 180 days shall be reported to the SCBMF for review with adequate reasoning justification thereof. Such cases shall also be subject to supervisory review the Reserve Bank.

4.1.6 In case an account is identified as a fraud by any bank, the borrowal accounts of other group companies 18, in which one or more promoter(s)/whole-time director(s) are common, shall also be subjected to examination by banks concerned from fraud angle under these Directions.

4.1.7 In cases where Law Enforcement Agencies (LEAs) have suo- motu initiated investigation involving a borrower account, bank/s shall immediately red-flag the account and follow the usual process for classification of account as fraud and complete the same within the stipulated period as specified at /Para 4.1.5 above."



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14. Thus, it can be seen that Clause 4 contains the directions to the banks to frame a policy with reference to engagement of external auditors and the conduct of audit and the standard of audit etc. As far as the instant case is concerned, I am of the view that the allegation is something else and one more entity being formed to utilise the self same premises and facility of the bank and this does not involve any nuances of auditing etc., and therefore, I am unable to accept the contention of the learned counsel for the petitioner that an internal or external audit is necessary. The entire Clause 4 if read in the context of the present facts, I am of the view that it cannot be read as making mandatory an internal or external audit. Therefore, unable to accept the submissions made by the learned counsel for the petitioner, this Writ Petition stands dismissed. No costs. Consequently, connected Miscellaneous Petition is closed.

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D.BHARATHA CHAKRAVARTHY, J.

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