*** THE HON'BLE THE CHIEF JUSTICE SRI RAGHVENDRA SINGH CHAUHAN**
AND
THE HON'BLE SRI JUSTICE B. VIJAYSEN REDDY

WRIT PETITION No. 19102 OF 2019

% 10.12.2020

Between:

Mr. Rajesh Agarwal,
S/o. Late Satyanarayan Agarwal,
Aged about 47 years, R/o. Signature One Block 3rd Floor,
Road No.4, Banjara Hills,
Hyderabad – 500 034.

... Petitioner

AND

Reserve Bank of India,
Through Regional Director, 6 Sansad Marg,
New Delhi,
And others.

...Respondents

Counsel for the petitioner: Mr. Mukul Rohatgi, Senior Counsel

for Mr. Tarun G. Reddy

Counsel for the respondents: Mr. B. Nalin Kumar
Mr. B. S. Prasad, Senior Counsel
For Mr. K. Surender
Mr. Namavarapu Rajeshwar Rao (ASSGI)
Mr. Maheshwar Rao Kunchem
Mr. M. V. Ramana
Pearl Law Associates

< Gist:

> Head Note:

? CITATIONS:

1. (2019) 6 SCC 787
2. 1993 Supp. (4) SCC 260
3. (2005) 7 SCC 764
4. (2010) 10 SCC 744
5. (2007) 7 SCC 555
6. (2006) 5 SCC 167
7. (1992) 4 SCC 363
8. AIR 2015 SC 1523
9. (2007) 5 SCC 428
10. (1969) 2 SCC 262
11. (1978) 1 SCC 405
12. AIR 1967 SC 1269
13. (1981) 1 SCC 664
14. (2008) 14 SCC 151
15. (2011) 13 SCC 733
16. (1988) 3 SCC 416

THE HON'BLE THE CHIEF JUSTICE SRI RAGHVENDRA SINGH CHAUHAN
AND
THE HON'BLE SRI JUSTICE B. VIJAYSEN REDDY

WRIT PETITION No. 19102 OF 2019

JUDGMENT: (Per Hon'ble the Chief Justice Sri Raghvendra Singh Chauhan)

Aggrieved by the non-inclusion of principles of natural justice in the Master Directions on Fraud ('the Master Circular', for short), dated 01.07.2016, issued under Section 35-A of the Banking Regulation Act, 1949 by the Reserve Bank of India, aggrieved by the decision of the Joint Lenders Forum ('the JLF', for short) dated 15-02-2019, and aggrieved by the resolution of the Fraud Identification Committee ('FIC', for short) dated 31.07.2019, whereby both the JLF and the FIC have classified the account of M/s. B. S. Limited, ('the Company', for short), of which the petitioner was the former Chairman and Managing Director, as 'fraud' and 'willful defaulter', the petitioner, Mr. Rajesh Agarwal, has approached this Court.

2. Briefly, the facts of the case are as under:

2.1. The petitioner was the Chairman and the Managing Director of the Company—a Company incorporated and registered under the Companies Act, 1956, having its registered office at Hyderabad. The Company was engaged in the business of Power Transmission & Distribution, Passive Telecom Infrastructure; it also worked in the area of Renewable Energy, and Mineral Resources. During the period 2006-2014, in the course of its business, the Company approached several banks, including the respondent Banks, and availed a loan of Rs.1406.00 Crores. In the year 2013, the Madhya Pradesh Power Transmission Company Limited ('MPPTCL') awarded the work of construction of 220KVA and 132KVA Sub-Stations, Transmission Lines, Augmentation Works and Feeder Way works to the Company. However, according to the MPPTCL, as there was delay in execution of the works, and shortage of working

capital, it terminated the contract with the Company. Consequently, the MPPTCL also encashed the bank guarantees of Rs. 140.00 Crores. Due to the cancellation of contract, and the encashment of the bank guarantee, the Company suffered huge financial losses. Consequently, the Company was unable to repay the loan amount to the Lender Banks. It, thus, committed default in repayment of the loan amounts.

2.2. As per the Circular Guidelines of the Reserve Bank of India ('RBI'), respondent No. 1, all Lender Banks, with the State Bank of India ('SBI'), respondent No. 2 as the Lead Bank, formed the JLF (*a Joint Lenders Forum).* On 29.06.2016 the JLF declared the Company's accounts as Non-Performing Assets ('NPAs', for short). On the same day, the JLF requested the Company to provide a Corrective Action Plan towards regularization of its account. Moreover, in accordance with the *Scheme for Sustainable Structuring of Stressed Assets* ('S4A', for short)—a scheme announced by the RBI vide Circular dated 13.06.2016, the JLF decided to adopt the said S4A scheme, and to conduct a Forensic Audit and Techno-Economic Viability ('TEV') in its meeting held on 11.07.2016.

2.3. According to the petitioner, the Company submitted clarifications to the Forensic Auditor. Basing on the Forensic Audit Report, dated 29.08.2016, on 31.08.2016, the JLF closed the issue observing that "*there were no irregularities, with regard to fraudulent transactions pointed out in the Forensic Audit Report*".

2.4. However, basing on the TEV Report, dated 14.09.2016, in its meeting, on 14.09.2016 itself, the JLF observed that the Company was ineligible for S4A scheme as there were no minimum prescribed free cash flows by the Company. Therefore, the JLF requested the Company to submit an alternative plan for regularization of its account. Consequently, the Company proposed a scheme under One Time Settlement ('OTS', for short). However, the said proposal was rejected by the JLF in February,

2018. Thereafter, one of the lender Banks, i.e. IDBI Bank, the respondent No. 9, declared the account of the Company as "Red Flagged Account" ('RFA', for short). Moreover, basing on the Second Forensic Audit Report, dated 06.04.2018, on 21.04.2018, the IDBI Bank called for explanation from the Company. Promptly, the Company submitted its reply on 24.04.2018. In its reply, the Company claimed that no irregular transactions had taken place during the audit period. But still, on 10.05.2018, the IDBI Bank, the respondent No.9, sought for further clarifications from the Company. The Company submitted its replies on 24.04.2018 and 10.05.2018.

2.5. Meanwhile, the SBI, the respondent No. 2, the Lead Bank, filed a petition under Section 7 of the Insolvency and Bankruptcy Code, 2016 ('the Code', for short) before the National Company Law Tribunal, Hyderabad Bench ('NCLT', for short). The petition was filed for declaring the Company as insolvent. By order, dated 01.11.2018, the NCLT admitted the application, and declared a moratorium against all proceedings towards the Company till the completion of Corporate Insolvency Resolution Process. Further, the NCLT appointed Dr. K.V. Srinivas, as Interim Resolution Professional ('IRP', for short); it directed the IRP to take charge of the management of the Company, and to issue the necessary public announcement. The NCLT also directed the IRP to discharge its functions under Section 20 of the Code. However, as the resolution plan could not revive the Company, by order dated 04.11.2019 the NCLT directed the winding up of the Company and appointed an Official Liquidator ('OL', for short).

2.6. While things stood thus, by invoking Clause 2.2.1(g) of the Master Circular, on 15.02.2019, the JLF declared the account of the Company as 'fraud'. Subsequently, on 31.07.2019, the FIC resolved to identify the Company's account as 'fraud'. Both the decisions by the JLF

and the FIC were, thus, taken prior to the appointment of the OL on 04.11.2019 by the NCLT.

2.7. Initially, the petitioner challenged only the decision of the JLF dated 15.02.2019 before this Court. The petitioner did not challenge the Resolution, dated 31.07.2019, passed by the FIC before this Court. However, when this lacuna was pointed out to the petitioner, subsequently the petitioner amended the writ petition, and challenged the same. The amendment application was allowed by this Court by order dated 07.09.2020. Thus, the present writ petition, with the aforementioned grievances, before this Court.

3. Mr. B.S. Prasad, the learned Senior Counsel for SBI Bank, has raised a preliminary objection, with regard to the maintainability of the writ petition before this Court. According to the learned Senior Counsel, the SBI had already approached the NCLT for declaring the Company as insolvent. By order, dated 01.11.2018, the NCLT had appointed the IRP; by order, dated 29.04.2019, the NCLT had extended the term of the IRP. Since the IRP could not resurrect the Company despite his best efforts, by order, dated 04.11.2019, the NCLT had appointed an OL. Once the OL had been appointed, the management of the Company falls within the jurisdiction of the OL. Therefore, the petitioner, who is a former Chairman and Managing Director of the Company, has no relevant role to play in the affairs of the Company. Hence, the petitioner lacks the *locus standi* to challenge the order, dated 15.02.2019 passed by the JLF, and the consequential resolution, dated 31.07.2019, passed by the FIC, and to challenge the legal validity of the Master Circular issued by the RBI.

3.1. Secondly, once a company's account is declared as 'fraud', or in other words, the company is declared as holder of fraudulent account, the civil and criminal consequences will be faced by the Company, and not by the petitioner. Therefore, the petitioner is unjustified in claiming that

his fundamental and civil rights are being adversely affected by the impugned decision of the JLF, and the resolution of the FIC. Hence, the writ petition is not maintainable before this Court.

3.2. On the other hand, Mr. Mukul Rohatgi, the learned Senior Counsel for the petitioner, has argued that according to Clause 8.12.1 of the Master Circular, the penal provisions would not only affect the fraudulent borrower, i.e. the Company, but would also adversely affect the Promoter, Directors and other Whole Time Directors of the Company, such as the petitioner. For, these Directors would be debarred from availing the bank finance from Scheduled Commercial Banks, Development Financial Institutions, Government owned NBFCs, Investment Institutions, etc., for a period of five years from the date of full payment of the defrauded amount. Even after the lapse of five years, discretion is given to the financial institutions to decide whether to lend money to the Director(s) of the Company or not. Therefore, the petitioner would be denied the right to borrow finances from financial institutions at least for five years, and perhaps, for the rest of his life. Consequently, the petitioner would be denied the fundamental right to carry on a trade, or a business. Hence, the impugned decision of the JLF, and the resolution of the FIC adversely affect the petitioner's fundamental right under Article 19(1)(g) of the Constitution of India. Further, since the right to livelihood has been interpreted as part of the fundamental right to life, under Article 21 of the Constitution of India, the impugned decisions also adversely affect the petitioner's fundamental right under Article 21 of the Constitution of India. Therefore, the petitioner does have the right to challenge the said decisions.

3.3. Secondly, the account of the Company has been declared as 'fraud' by the JLF and the FIC without giving either the Company, or the petitioner an opportunity of hearing. The opportunity of hearing has been denied to the petitioner and the Company ostensibly on the ground that

the Master Circular does not include the right of hearing in its scope and ambit. Therefore, the petitioner has a right to challenge the constitutionally validity of the Master Circular. Moreover, the petitioner has raised seminal constitutional issue with regard to the interpretation and legal validity of the Master Circular. Hence, the petition deserves to be entertained and, indeed, allowed.

3.4. Thirdly, even if the NCLT has appointed the OL, even then it does not preclude the petitioner from challenging the impugned decisions, and from challenging the Master Circular before this Court. Since the petitioner's fundamental rights are being adversely affected by the Master Circular, and by the impugned decision of the JLF, and the resolution of the FIC, the petitioner is legally entitled to challenge the same before this Court under Article 226 of the Constitution of India.

4. Heard the learned counsel for the parties on the preliminary objection.

5. Although this Court will deal with other clauses of the Master Circular in the later part of the judgment, for the present, to decide the preliminary objection, it is imperative to consider Clause 8.12.1 and 8.12.2 of the Master Circular.

6. Clause 8.12.1 and Clause 8.12.2 of the Master Circular are as under:-

> ***8.12.1***. *In general, the penal provisions as applicable to willful defaulters would apply to the fraudulent borrower including the promoter director(s) and other whole time directors of the company insofar as raising of funds from the banking system or from the capital markets by companies with which they are associated is concerned, etc. In particular, borrowers who have defaulted and have also committed a fraud in the account would be debarred from availing bank finance from Scheduled Commercial Banks, Development Financial Institutions, Government owned NBFCs, Investment Institutions, etc., for a period of five years from the date of full payment of the defrauded amount. After this period, it is for individual institutions to take a call on whether to lend to such a borrower. The penal provisions would apply to non-whole time directors (like nominee directors and independent directors) only in rarest of cases based on conclusive proof of their complicity.*

> ***8.12.2***. *No restructuring or grant of additional facilities may be made in the case of RFA or fraud accounts. However, in cases of fraud/malfeasance where the existing promoters are replaced by new promoters and the borrower company is totally delinked from such erstwhile promoters/management, banks and JLF may take a view on restructuring of such accounts based on their viability, without prejudice to the continuance of criminal action against the erstwhile promoters /management.*

7. A bare perusal of Clause 8.12.1 of Master Circular clearly reveals that once a company is declared to be a fraudulent borrower, "*the Promoter, Director(s) and other whole time Directors of the company*" are denied a right to avail the bank finance from the financial institutions for a period of five years. Even after the period of five years, it is for the financial institutions to decide whether to lend monies to the Director(s) of the company or not? Moreover, under Clause 8.12.2 of the Master Circular, "*the Directors are denied restructuring or grant of additional facilities by the financial institutions*". Thus, obviously once a company is declared as a fraudulent borrower, the Director's civil and fundamental rights are adversely affected to a great extent. For, with the denial of financial assistance from the banking/financial sector, that too for a period of five years or more, the Director(s), such as the petitioner, cannot easily carry on any business or trade. Moreover, they would also be denied of additional facilities by the financial institutions. Considering the fact that the Director(s) would be branded as a 'fraudster', the chances of his/her being lent money, or finances, by a financial institution is rather slim. Therefore, the learned Senior Counsel for the petitioner is well justified in claiming that such a declaration by the JLF, and by the FIC adversely affects, both the civil and fundamental rights of the petitioner. Needless to say, once the civil or fundamental rights of a person are affected, the person does have the right of access to justice under Article 226 of the Constitution of India.

8. In the case of **SBI v. Jah Developers (P) Limited**[1] while dealing with the case of willful defaulter, the Hon'ble Supreme Court has opined that being declared as willful defaulter would adversely affect the fundamental right of the Director(s) under Article 19 (1) (g) of the Constitution of India. The same logic would apply with greater force in the present case. For, the declaration of being holder of a fraudulent account has far more serious consequences than being declared as a willful defaulter. Hence, undoubtedly, the fundamental rights of the petitioner would be adversely affected by the decision of the JLF, and by the resolution of the FIC. Thus, the petitioner does have the right to file the present writ petition before this Court.

9. Moreover, even if the OL has been appointed by NCLT, by its order, dated 04.11.2019, it does not pre-empt the petitioner from challenging the impugned decisions, and the legality of the Master Circular. Furthermore, the impugned decisions were taken by the JLF on 15.02.2019, and by the FIC on 31.07.2019, whereas the OL was appointed on 04.11.2019. Thus, the OL was appointed after the decisions were taken by the JLF and the FIC. Further, mere appointment of an OL does not dilute the impact of Clause 8.12.1 and Clause 8.12.2 of the Master Circular. Therefore, the petitioner can still challenge the legality of the Master Circular, and also the impugned decisions mentioned hereinabove. Hence, this Court does not find any force in the preliminary objection raised by Mr. B.S. Prasad, the learned Senior Counsel for the respondent No. 2. Thus, the preliminary objection is, hereby, rejected.

10. Mr. Mukul Rohatgi, the learned Senior Counsel appearing for the petitioner, has raised the following contentions before this Court:-

10.1. Firstly, the Master Circular issued on 01.07.2016 (updated on 03.07.2017) has been issued under Section 35-A of the Banking Regulation Act, 1949. Thus, the Master Circular has statutory force.

---

[1] (2019) 6 SCC 787

10.2. Secondly, the Master Circular is an elaborate one, which not only reveals the purpose of the Circular, but also contains general and specific guidelines to be followed by the banks. Furthermore, it contains elaborate procedure for dealing with borrowers. Hence, it has prescribed different steps to be taken, and different stages to be reached before declaring an account as 'fraud', or the borrower as 'dealing with a fraudulent account'. But despite the different stages prescribed, and the elaborate procedure laid down, a crucial step is conspicuously missing: giving an opportunity of hearing to the borrower before declaring the account of the borrower as 'fraud' or declaring the borrower as 'a fraudster', or 'a holder of a fraudulent account'.

10.3. Thirdly, upon declaration of a borrower as a fraudster, grave criminal and civil consequences automatically follow. According to Clause 8.9.5, once the JLF decides, either by consensus, or by majority, to classify the account as 'fraud', it must immediately report its decision to the RBI, and within thirty days, a complaint should be lodged with the CBI or other law enforcement agency. According to Clause 8.11.1, "*the banks are required to lodge the complaint with the law enforcement agencies immediately on detection of fraud. There should ideally not be any delay in filing of the complaints with the law enforcement agencies since delays may result in the loss of relevant 'relied upon' documents, non-availability of witnesses, absconding of borrowers and also the money trail getting cold in addition to asset stripping by the fraudulent borrower*". Thus, there is a penal consequence as the borrower immediately gets entangled in a criminal case. Such entanglement adversely affects both the goodwill of the person in the market, and his reputation in the society. Besides, the person is required to go through the rigors of a criminal trial.

10.4. Fourthly, likewise, there are civil consequences immediately after a borrower is declared to be holder of a fraudulent account—consequences mentioned hereinabove. Despite the fact that grave penal

and civil consequences immediately adversely affect the fundamental and civil rights of the borrower, the Master Circular does not prescribe an opportunity of hearing to be given to the borrower before the JLF.

10.5. Fifthly, ironically, while the borrower is not provided with an opportunity of hearing, according to Clause 8.12.4, third parties, such as builders, warehouse/cold storage owners, motor vehicle/tractor dealers, travel agents etc., and professionals such as architects, valuers, chartered accountants, advocates etc., who are also held to be accountable if they played a vital role in credit sanction/disbursement, or facilitated the preparation of frauds, such persons have to be provided with an opportunity of hearing under Clause 8.12.5. Thus, while others who may be remotely related to the alleged fraud are provided with an opportunity of hearing, the same is denied to the borrower.

10.6. Sixthly, relying on the case of **Jah Developers (P) Limited** (supra) the learned Senior Counsel has pleaded that the said case deals with the case of willful defaulters. The case of willful defaulters is on a lower rung than a case of borrower/holder of a fraudulent account. Yet, in the **Jah Developers (P) Limited** (supra), while dealing with the case of willful defaulters, the Hon'ble Supreme Court has opined that before the borrower can be declared as a willful defaulter, an opportunity of hearing necessarily has to be given to the borrower. Therefore, while an opportunity of hearing is being given to a willful defaulter – a borrower who allegedly has committed a lesser civil wrong, a fraudster who has allegedly committed a graver civil wrong, is denied an opportunity of hearing. Therefore, an opportunity of hearing would have to be necessarily read into the Master Circular.

10.7. Lastly, if the principles of natural justice were not read into the Master Circular, the Master Circular bestows the JLF and the FIC with unbridled power. The decision of the JLF and of the FIC would suffer from

arbitrariness, unreasonableness and unfairness. Thus, such a decision would be violative of Article 14 of the Constitution of India. Moreover, since such a decision would adversely affect the right to carry on a trade or business under Article 19 (1) (g) of the Constitution of India, and the right of livelihood of the borrower, and since the procedure is an unreasonable one, the Master Circular is violative of Article 21 of the Constitution of India. Hence, in order to save the Master Circular from being declared as constitutionally invalid, it is necessary that the principles of natural justice must be read into it by this Court.

11. Dealing with the factual matrix of the case, the learned Senior Counsel has raised the following contentions:-

11.1. Firstly, according to the JLF and the FIC, there were two reports prepared, namely one by M/s. J. Singh & Associates, Mumbai (Forensic Audit Report, dated 06.04.2018), and the other by Dr. K. V. Srinivas, IRP (Transaction Audit Report, dated Nil). However, the copies of these Reports were never furnished either to the petitioner, or the Company. Therefore, neither the petitioner, nor the Company was given an opportunity to explain, or to challenge the findings of these two Reports.

11.2. Secondly, although the IDBI Bank has mentioned the Forensic Audit Report, dated 06.04.2018, in its letter dated 21.04.2018, but the Bank has merely paraphrased the abstracts of the Report. Since the exact words of the Report, and the copy of the Report were not given to the Company, or to the petitioner, neither of them could properly submit their explanation to the findings of the Forensic Audit Report. Therefore, the petitioner was denied a substantive opportunity of hearing, both by the IDBI Bank, and by the JLF.

11.3. Thirdly, the minutes of the meeting held by the JLF on 15.02.2019 reveal interesting facts of the meeting : (i) on four different

points, (namely in item Nos.2, 4, 5 & 8) the JLF had perused the Report of the Forensic Auditor, and had agreed to close these four different factors which were initially read against the borrower. For, the JLF was satisfied by the explanation given by the borrower Company to the Forensic Auditor; (ii) on three different accounts (in item Nos. 1, 3 and 8) the JLF had decided to call for further clarification from the Forensic Auditor. However, the JLF was of the opinion that "*if no clarification is sought from the Forensic Auditor", the account will be classified as 'fraud'*". According to the learned Senior Counsel, 'fraud' cannot be presumed or alleged; it must be established. Moreover, as pointed out above, on the basis of the clarification submitted by the borrower, and on the basis of the finding of the Forensic Auditor on four different accounts, the objections raised by the JFL were closed. Therefore, according to the learned Senior Counsel, before declaring the Company's account as 'fraud', in fact, the JLF should have waited for further clarification by the Forensic Auditor. But instead of doing so, the JLF jumped to the conclusion that the Company is not only holder of a fraudulent account, but is also a 'willful defaulter'; (iii) as far as the analysis dealing with the trading activity other than coal is concerned, an inconclusive decision was reached. Despite an inconclusive decision, the JLF has decided to declare the account held by the Company as 'fraud' that too, '*for the above reasons*'; (iv) on the one hand, the JLF had ordered that further clarification be sought from the Forensic Auditor, yet on the other hand, the JLF concluded that "*hence, it was unanimously decided that the account be treated as fraud for the above reasons*". Once the JLF is waiting for further clarification from the Forensic Auditor, it is unjustified in declaring the account of the Company as 'fraud'. After all, such a conclusion could not be reached conclusively till all the evidence was available with the JLF; (v) if the Company were given an opportunity of hearing, it could have easily explained the finding of the Forensic Auditor. It could also have cleared the doubts in the mind of the JLF,

with regard to the specific aspects of the case. But without giving such an opportunity of hearing, behind the back of the Company, the JLF has jumped the gun; it has declared the Company's account as 'fraud'. As pointed out hereinabove, both the penal and civil consequences have come into effect immediately after such a declaration by the JLF.

11.4. Fourthly, the FIC has referred to a report submitted by Dr. K.V. Srinivas, IRP. However, the said Report has neither seen the light of the day, nor been referred to by the JLF. Thus, the Report is an unknown piece of evidence which has been read against the Company.

11.5. Fifthly, even the resolution passed by the FIC is a mechanical one. For, the FIC has not waited for any clarification to be offered by the Forensic Auditor. Moreover, even the FIC has not given an opportunity of hearing to the Company. Therefore, the principles of natural justice have been violated. Hence, the impugned decision dated 15.02.2019, and the resolution dated 31.07.2019, deserve to be set aside by this Court.

12. On the other hand, Mr. Nalin Kumar, the learned Standing Counsel for RBI, and Mr. B.S. Prasad, the learned Senior Counsel for the SBI, have vehemently raised the following counter-arguments:

12.1. Firstly, the purpose of the Master Circular is to detect frauds, in the banking system, as expeditiously as possible, and to report the fraud both to the RBI, and to the law enforcement agencies. The Master Circular aims to enable "*faster dissemination of information by the Reserve Bank of India to banks on the details of frauds, unscrupulous borrowers and related parties, based on banks' reporting so that necessary safeguards / preventive measures by way of appropriate procedures and internal checks may be introduced and caution exercised while dealing with such parties by banks*". Therefore, according to both the learned counsel, it is imperative that a decision be taken by the JLF at the earliest to declare the account as 'fraud', to report its decision to the RBI, and to expeditiously initiate the criminal investigation. Moreover, in case the

decision is not taken expeditiously, and not reported to the RBI, or to the investigating agency, fraudsters will continue to play fraud on other banks. Such illegal actions on their part will endanger the stability of the banking sector. Since the banking sector deals with the monies of the public at large, it is in the interest of the public that the decision be taken as quickly as possible without undue wastage of time. It is for these reasons, that the Master Circular purposefully does not include an opportunity of hearing being given to the borrower.

12.2. Secondly, the very title of the Master Circular i.e. "*Classification and Reporting....*" clearly indicates that there are two purposes of the Circular, namely (i) to classify an account as 'fraud', and (ii) to report the decision both to the RBI and to the law enforcement agencies. Since the decision and investigation needs to be fast paced, the requirement of principles of natural justice should not be read into the Circular.

12.3. Thirdly, the meeting of the JLF is not an adjudicatory process; it is merely an administrative function. Therefore, the principles of natural justice cannot be read as part and parcel of the procedure to be adopted by the JLF. Hence, the principles of natural justice cannot be read into the Master Circular. Therefore, there is no need to give an opportunity of hearing to the borrower before declaring the borrower's account as 'fraud'.

12.4. Fourthly, the purpose of reaching the conclusion is to set the criminal law into motion by reporting the fraud to the investigating agencies. According to Mr. B. Nalin, the lodging of a complaint with the investigating agencies is akin to filing an F.I.R. under Section 154 of Cr. P. C. Hence, there is no legal requirement of giving an opportunity of hearing to the alleged accused. Therefore, the principles of natural justice cannot and should not be read into the Master Circular.

12.5. Fifthly, the application of principles of natural justice is not a universal one. Indeed, there are circumstances where the said principles can be ignored. In order to support this plea, the learned counsel have relied on **Union of India v. W. N. Chadha**[2], **Ajit Kumar Nag v. General Manager (PJ), Indian Oil Corporation Limited**[3] and **CCI v. SAIL**[4]. Therefore, the existence of principles of natural justice cannot be read in every statute, or a circular. There are, indeed, certain circumstances, such as dire urgency, where the principles of natural justice can be denied to a person. Since the Company is a holder of a fraudulent account, the Company need not be given an opportunity of hearing.

12.6. Lastly, as far as the decision of the Apex Court in the case of **Jah Developers (P) Limited** (supra) is concerned, the learned counsel have pleaded that the said case deals with 'willful defaulters', and not with 'fraudster'. Therefore, the opinion of the Hon'ble Supreme Court qua willful defaulters cannot be applied, and should not be applied to the case of a fraudster. Moreover, an obiter of the Apex Court is not binding on the High Court. In order to support this contention, the learned counsel have relied on **Girnar Traders v. State of Maharashtra**[5], **State of Haryana v. Ranbir**[6], and **C.I.T. v. Sun Engineering Works (P) Limited**[7].

13. While dealing with the factual matrix of the case, Mr. B.S. Prasad, the learned Standing Counsel for SBI, has raised the following counter-contentions:-

13.1. Firstly, the IDBI Bank had brought the Forensic Audit Report to the notice of the borrower Company in its letter, dated 21.04.2018. In fact, the Company had replied to the same. Therefore, the petitioner is unjustified in claiming that the Company was not given an opportunity of hearing by the JLF.

---

[2] 1993 Supp. (4) SCC 260
[3] (2005) 7 SCC 764
[4] (2010) 10 SCC 744
[5] (2007) 7 SCC 555
[6] (2006) 5 SCC 167
[7] (1992) 4 SCC 363

13.2. Secondly, according to the Final Assessment Order, dated 29.11.2017, the Income Tax Department had also noticed that some sham transactions were carried out by the Company. Therefore, the JLF was justified in declaring the borrower as a holder of a fraudulent account. Moreover, in its order dated 27.02.2018, the NCLT had noticed the fact that the Company had huge trade receivables. Yet, it could not release/recover any of the outstanding trade receivables. Therefore, apparently, the Company had played fraud. Hence, the JLF was justified in concluding that the Company is a holder of a fraud account. Therefore, according to the learned counsel, the impugned order should not be set aside by this Court.

13.3. Lastly, the FIC has considered the entire material which was placed before it; it had legally concluded that the Company was holder of a 'fraud' account. Hence, the learned Senior Counsel has supported both the impugned orders.

14. In rejoinder, Mr. Mukul Rohatgi, the learned Senior Counsel, has submitted the following arguments:-

14.1. Firstly, the Master Circular is rather confusing, thus, vague. For Clause 8.12.1 of the Master Circular, dealing with penal consequences, firstly states that the procedure for declaring a borrower as a willful defaulter should be followed. Moreover, according to the Hon'ble Supreme Court in the case of **Jah Developers** (supra), before a borrower can be declared as a 'willful defaulter', the borrower has to be given an opportunity of hearing by the JLF. Yet, the Master Circular dealing with fraud account denies such an opportunity of hearing to a borrower who may be declared as holder of fraud account. But simultaneously, the impugned Master Circular prescribes that the procedure for declaring the borrower as 'willful defaulter' would have to be followed. Thus, it is unclear whether an opportunity of hearing should be given under Clauses 8.9.4 and 8.9.5 of the Master Circular, or not? Relying on the case of

Shreya Singhal v. Union of India[8], the learned Senior Counsel pleads that the impugned Master Circular should be declared as legally invalid on the ground of vagueness.

14.2. Secondly, relying on **Oriental Insurance CO. LTD. V. Meena Variyal**[9], the learned counsel has pleaded that even an obiter opinion of the Apex Court is, indeed, binding on the High Courts. Therefore, the opinion expressed by the Apex Court in the case of **Jah Developers (P) Limited** (supra), even if considered to be an obiter, would equally be binding on this Court. Moreover, in the impugned order, dated 15.02.2019, the JLF has not just declared the Company as holder of a fraud account, but more so has declared the Company as a 'willful defaulter'. Therefore, even before declaring the Company as a willful defaulter, an opportunity of hearing had to be given in accordance with the principles laid down by the Apex Court in the case of **Jah Developers (P) Limited** (supra).

14.3. Thirdly, the contention raised on the basis of the Final Assessment Order of the Income Tax Department, dated 29.11.2017, is highly misplaced. For, the said Final Assessment Order was challenged before the Income Tax Tribunal. By order, dated 29.11.2018, the Income Tax Tribunal had set aside the Final Assessment Order. Therefore, by relying upon the Final Assessment Order, the learned Standing Counsel for the SBI is cleverly trying to mislead this Court.

14.4. Lastly, even the alleged finding given by the NCLT is irrelevant. For, the said finding was given after the decision was taken by the JLF on 15.02.2019. Most importantly, neither the Final Assessment Order passed by the Assessing Authority, dated 29.11.2017, nor the finding given by the NCLT form the basis of the decision reached by the

---

[8] AIR 2015 SC 1523
[9] (2007) 5 SCC 428

JLF in its meeting, dated 15.02.2019. Hence, the reliance on both these documents is highly mischievous.

15. Heard the learned counsel for the parties, perused the impugned Master Circular, examined the impugned orders, and considered the record submitted by the respective parties.

16. The issues before this Court are:-

A) Whether the principles of natural justice, especially *audi alteram partem* (giving opportunity of hearing to the other side) should be read into the Master Circular or not?

B) Whether the JLF was justified in concluding in its meeting, dated 15.02.2019 that the borrower Company is holder of fraudulent account or not?

C) Whether the FIC was justified in concluding that the borrower Company is a holder of fraudulent account or not? And

D) Relief.

17. However, the issue, with regard to declaring the Company as a 'willful defaulter', has not been argued before this court. Therefore, the said issue is left open in the present case.

18. The principles of natural justice are like a clear sunshine which pervade and permeate into the deepest dark corners, and kill the germs of injustice. The principles of natural justice rein in arbitrary, discriminatory and irrational decisions. They protect an individual from the might of the State, or its instrumentalities. They provide a succor to the common man; they assure the common man that justice not only appears to be done, but is being done to his/her cause. By assuring the people that justice has, indeed, been done, the principles of natural justice restore and strengthen the faith and belief of the people in the rule of law. Not only the three branches of the State, but the State itself rests and progresses on the faith of its people. For, when the faith of the people is shaken, the people may demolish the very foundation of the State. Hence,

the principles of natural justice serve myriad purposes. These purposes may not be explicit, but nonetheless, intrinsically they play a vital role in maintaining the metabolism of the State.

19. In the case of **A. K. Kraipak v. Union of India**[10], the Hon'ble Supreme Court had clearly noticed that "*the dividing line between an administrative power and a quasi-judicial power is quite thin and is being gradually obliterated*". What was opined in the year 1969 was further confirmed, a decade later, in the case of **Mohinder Singh Gill v. Chief Election Commissioner**[11]. The Hon'ble Supreme Court had clearly declared that "*the distinction between administrative and quasi-judicial functions are (sic) no longer relevant. The principles of natural justice are as much applicable to an administrative action as they are to a quasi-judicial one*". Therefore, it is irrelevant whether the function of the JLF, or of the FIC is an administrative one, or a quasi-judicial one. Even if JLF performs an administrative function, the moot issue is whether the principles of natural justice should still be read into its procedure, or not?

20. Lord Parker in the Queen's Bench decision in *In re H.K. (Infants) [(1963) 3 All ER 191*] had opined that "*as good administration and an honest or bona fide decision require not merely impartiality or merely bringing one's mind to bear on the problem, but acting fairly. Thus irrespective of whether the power conferred on a statutory body or tribunal is administrative or quasi-judicial, a duty to act fairly, that is, in consonance with the fundamental principles of substantive justice is generally implied, because the presumption is that in a democratic polity wedded to the rule of law, the State or the legislature does not intend that in the exercise of their statutory powers its functionaries should act unfairly or unjustly*".

---

[10] (1969) 2 SCC 262
[11] (1978) 1 SCC 405

21. In the case of **State of Orissa v. Binapani Dei**[12], the Apex Court has observed as under:-

> ***9.*** *... An order by the State to the prejudice of a person in derogation of his vested rights may be made only in accordance with the basic rules of justice and fair play. The deciding authority, it is true, is not in the position of a Judge called upon to decide an action between contesting parties, and strict compliance with the forms of judicial procedure may not be insisted upon. He is however under a duty to give the person against whom an enquiry is held an opportunity to set up his version or defence and an opportunity to correct or to controvert any evidence in the possession of the authority which is sought to be relied upon to his prejudice. For that purpose the person against whom in enquiry is held must be informed of the case he is called upon to meet, and the evidence in support thereof. The rule that a party to whose prejudice an order is intended to be passed is entitled to a hearing applies alike to judicial tribunals and bodies of persons invested with authority to adjudicate upon matters involving civil consequences. It is one of the fundamental rules of our constitutional set-up that every citizen is protected against exercise of arbitrary authority by the State or its officers. Duty to act judicially would therefore arise from the very nature of the function intended to be performed: it need not be shown to be super-added. If there is power to decide and determine to the prejudice of a person, duty to act judicially is implicit in the exercise of such power. If the essentials of justice be ignored and an order to the prejudice of a person is made, the order is a nullity. That is a basic concept of the rule of law and importance thereof transcends the significance of a decision in any particular case.*
>
> ***12.*** *... It is true that the order is administrative in character, but even an administrative order which involves civil consequences, as already stated, must be made consistently with the rules of natural justice after informing the first respondent of the case of the State, the evidence in support thereof and after giving an opportunity to the first respondent of being heard and meeting or explaining the evidence. No such steps were admittedly taken, the High Court was, in our judgment, right in setting aside the order of the State.*

22. In the case of **Swadeshi Cotton Mills v. Union of India**[13], the Apex Court posed two questions: what is natural justice? And what is the extent of applicability of principles of natural justice? The Hon'ble Supreme Court opined as under:-

---

[12] AIR 1967 SC 1269
[13] (1981) 1 SCC 664

> ***26.*** *Well then, what is "natural justice"? The phrase is not capable of a static and precise definition. It cannot be imprisoned in the straight-jacket of a cast-iron formula. Historically, "natural justice" has been used in a way "which implies the existence of moral principles of self-evident and unarguable truth". [Paul Jackson : Natural Justice, 2nd Edn., p 1] In course of time, Judges nurtured in the traditions of British jurisprudence, often invoked it in conjunction with a reference to "equity and good conscience". Legal experts of earlier generations did not draw any distinction between "natural justice" and "natural law". "Natural justice" was considered as "that part of natural law which relates to the administration of justice". Rules of natural justice are not embodied rules. Being means to an end and not an end in themselves, it is not possible to make an exhaustive catalogue of such rules.*
>
> ***27.*** *But two fundamental maxims of natural justice have now become deeply and indelibly ingrained in the common consciousness of mankind, as pre-eminently necessary to ensure that the law is applied impartially, objectively and fairly. Described in the form of Latin tags these twin principles are: (i) audi alteram partem and (ii) nemo judex in re sua. For the purpose of the question posed above, we are primarily concerned with the first. This principle was well-recognised even in the ancient world. Seneca, the philosopher, is said to have referred in Medea that it is unjust to reach a decision without a full hearing. In Maneka Gandhi case [(1978) 1 SCC 405 : (1978) 2 SCR 272] , Bhagwati, J. emphasised that audi alteram partem is a highly effective rule devised by the courts to ensure that a statutory authority arrives at a just decision and it is calculated to act as a healthy check on the abuse or misuse of power. Hence its reach should not be narrowed and its applicability circumscribed.*
>
> (Emphasis added)

23. In the case of **Mohinder Singh Gill** (supra), Hon'ble Mr. Justice V. R. Krishna Iyer had opined that "*natural justice is now a brooding omnipresence although varying in its play. …Its essence is good conscience in a given situation; nothing more – but nothing less*".

24. In the case of **Swadeshi Cotton Mills** (supra), the Hon'ble Supreme Court has further opined as under:-

> ***31.*** *The rules of natural justice can operate only in areas not covered by any law validly made. They can supplement the law but cannot supplant it (per Hedge, J. in A.K. Kraipak [supra]). If a statutory provision either specifically or by inevitable implication excludes the application of the rules of natural justice, then the court cannot ignore the mandate of the legislature. Whether or not the application of the principles of natural justice in a given case has been excluded, wholly or in part, in the exercise of statutory power, depends upon the*

language and basic scheme of the provision conferring the power, the nature of the power, the purpose for which it is conferred and the effect of the exercise of that power. (see Union of India v. Col. J.N. Sinha [(1970) 2 SCC 458])

32. *The maxim audi alteram partem has many facets. Two of them are: (a) notice of the case to be met; and (b) opportunity to explain. This rule is universally respected and duty to afford a fair hearing in Lord Lore-burn's oft-quoted language, is "a duty lying upon everyone who decides something", in the exercise of legal power. The rule cannot be sacrificed at the altar of administrative convenience or celerity; for, "convenience and justice" — as Lord Atkin felicitously put it — "are often not on speaking terms [General Medical Council v. Spackman, 1943 AC 627, 638] .*

(Emphasis added)

25. The Hon'ble Supreme Court further summarized the position as under:-

44. *In short, the general principle — as distinguished from an absolute rule of uniform application — seems to be that where a statute does not, in terms, exclude this rule of prior hearing but contemplates a post-decisional hearing amounting to a full review of the original order on merits, then such a statute would be construed as excluding the audi alteram partem rule at the pre-decisional stage. Conversely, if the statute conferring the power is silent with regard to the giving of a pre-decisional hearing to the person affected and the administrative decision taken by the authority involves civil consequences of a grave nature, and no full review or appeal on merits against that decision is provided, courts will be extremely reluctant to construe such a statute as excluding the duty of affording even a minimal hearing shorn of all its formal trappings and dilatory features at the pre-decisional stage, unless, viewed pragmatically, it would paralyse the administrative progress or frustrate the need for utmost promptitude. In short, this rule of fair play "must not be jettisoned save in very exceptional circumstances where compulsive necessity so demands". The court must make every effort to salvage this cardinal rule to the maximum extent possible, with situational modifications. But, to recall the words of Bhagwati, J., the core of it must, however, remain, namely, that the person affected must have reasonable opportunity of being heard and the hearing must be a genuine hearing and not an empty public relations exercise.*

(Emphasis added)

26. In a series of cases, dealing with Income Tax Act, dealing with Excise Act, or Mines and Minerals Act, the Hon'ble Supreme Court was faced with the issue whether to read the principles of natural justice in

these Acts when the Acts themselves are silent about importing the principles of natural justice within its provisions?

27. In the case of **Sahara India (Firm) v. Commissioner of Income Tax, Central-I**[14], the Hon'ble Supreme Court was dealing with the issue, with regard to reading the principles of natural justice within Section 142(2-A) of Income Tax Act. Section 142(2-A) of Income Tax Act prescribes that after seeking the approval of the Chief Commissioner, or Commissioner of Income Tax, the Assessing Officer may direct the assessee to get the accounts audited by an accountant (generally referred to as 'the special accountant'). Since the Assessing Officer was required to formulate an opinion, with regard to 'nature and complexity of the accounts', and 'in the interest of the revenue', the issue before the Hon'ble Supreme Court was whether prior to directing the assessee to have his accounts audited by the special accountant, the assessee needs to be given an opportunity of hearing or not? The Hon'ble Supreme Court observed as under:-

> ***6.*** *A bare perusal of the provisions of sub-section (2-A) of the Act would show that the opinion of the assessing officer that it is necessary to get the accounts of the assessee audited by an accountant has to be formed only by having regard to: (i) the nature and complexity of the accounts of the assessee; and (ii) the interests of the Revenue. The word "and" signifies conjunction and not disjunction. In other words, the twin conditions of "nature and complexity of the accounts" and "the interests of the Revenue" are the prerequisites for exercise of power under Section 142(2-A) of the Act. Undoubtedly, the object behind enacting the said provision is to assist the assessing officer in framing a correct and proper assessment based on the accounts maintained by the assessee and when he finds the accounts of the assessee to be complex, in order to protect the interests of the Revenue, recourse to the said provision can be had.*

It further opined that "*before dubbing the accounts to be complex or difficult to understand, there has to be a genuine and honest attempt on the part of the assessing officer to understand accounts maintained by the assessee; appreciate the entries made therein and in the event of any doubt, seek*

---

[14] (2008) 14 SCC 151

explanation from the assessee. But, opinion required to be formed by the assessing officer for exercise of power under the said provision must be based on objective criteria and not on the basis of subjective satisfaction". The Hon'ble Supreme Court also noted that "*the question for adjudication is whether in view of the fact that the said provision does not postulate the requirement of a hearing before an order for special audit is passed, a pre-decisional hearing is required to be given to the assessee or not?*" The Apex Court finally concluded that "*the upshot of the entire discussion is that the exercise of power under Section 142(2-A) of the Act leads to serious civil consequences and, therefore, even in the absence of express provision for affording an opportunity of pre-decisional hearing to an assessee and in the absence of any express provision in Section 142(2-A) barring the giving of reasonable opportunity to an assessee, the requirement of observance of principles of natural justice is to be read into the said provision*".

28. In the case of **Kesar Enterprises Limited v. State of U.P.**[15], the Hon'ble Supreme Court dealt with the interpretation of Rule 633 of the U.P. Excise Manual. Rule 633 of the Excise Manual permitted any person to export in bond foreign liquor manufactured at a distillery in Uttar Pradesh to any place in India under a pass in form PD 25 granted by the State under the provisions of Rule 633 of the Excise Manual. Rule 633(3) of the U.P. Excise Manual required the exporter of the bond foreign liquor to produce a certificate signed by the Collector, Deputy Commissioner or other officer specially appointed in this behalf, of the importing district certifying the due arrival or otherwise of the spirit at its destination. Rule 633(7) of the Excise Manual contained a penal provision, wherein if the certificate is not received within time mentioned in the bond or pass, or if on receipt of the certificate it appears that any of the conditions of the bond have been infringed, the Collector of the exporting district or the Excise Inspector who granted the pass, was empowered to take necessary

[15] (2011) 13 SCC 733

steps to recover from the executant or his surety the penalty due under the bond.

29. The issue before the Hon'ble Supreme Court was "*whether the principles of natural justice demand that an opportunity of hearing should be afforded before an order under Rule 633(7) of the Excise Manual is made*?" The Hon'ble Supreme Court first dealt with the aspect of principles of natural justice, which reads as under:-

> ***24.*** *Rules of "natural justice" are not embodied rules. The phrase "natural justice" is also not capable of a precise definition. The underlying principle of natural justice, evolved under the common law, is to check arbitrary exercise of power by the State or its functionaries. Therefore, the principle implies a duty to act fairly i.e. fair play in action.*

30. Relying on its earlier decisions, rendered in **A. K. Kraipak** (supra), **Swadeshi Cotton Mills** (supra), and **Sahara India (Firm)** (supra), the Hon'ble Supreme Court concluded that "*if the requirement of an opportunity to show cause is not read into the said Rule, an action thereunder would be open to challenge as violative of Article 14 of the Constitution of India on the ground that the power conferred on the competent authority under the provision is arbitrary*".

31. In the case of **State of Haryana v. Ram Kishan**[16], the Hon'ble Supreme Court dealt with the scope and ambit of Section 4-A of the Mines and Minerals (Regulation and Development) Act, 1957 ('the Act', for short). Section 4-A of the Act permitted the State Government to prematurely terminate a mining lease in respect of any mineral, after consultation with the Central Government. The mining lease could be terminated prematurely where the Central Government had consulted the State Government or *vice versa*. However, Section 4-A of the Act did not incorporate the principles of natural justice, i.e. an opportunity of hearing to be given to the lease holder of the mining operations, prior to the premature termination of the lease. Therefore, the question that arose

[16] (1988) 3 SCC 416

before the Hon'ble Supreme Court was *"whether the requirement of principles of natural justice should be read into Section 4-A of the Act or not?"* The Hon'ble Supreme Court finally concluded that *"the Section must be interpreted to imply that the person who may be affected by such a decision should be afforded an opportunity to prove that the proposed step would not advance the interest of mines and mineral development. Not to do so will be violative of the principles of natural justice. Since there is no suggestion in the section to deny the right of the affected persons to be heard, the provisions have to be interpreted as implying to preserve such a right"*. Relying on the case of **Baldev Singh v. State of Himachal Pradesh** [(1987) 2 SCC 510], the Apex Court further went on to observe that "*where exercise of a power results in civil consequences to citizens unless the statute specifically rules out the application of natural justice, such rule would apply*".

32. In the case of **Mohinder Singh Gill** (supra), the Apex Court had posed the question "*what is civil consequence?*" The Hon'ble Supreme Court had answered the question by stating that *"'civil consequence' undoubtedly cover infraction of not merely property or personal rights but of civil liberties, material deprivations and non-pecuniary damages. In its comprehensive connotation, everything that affects a citizen in his civil life inflicts a civil consequence*".

33. The following principles can easily be deducted from the case law mentioned hereinabove, as under:-

(i) Principles of natural justice have brooding *omnipresence*;

(ii) Although the principles of natural justice are not codified, nonetheless, they are applicable both to administrative and quasi-judicial decisions;

(iii) They do not supplant the law, but merely supplement the law;

(iv) Unless expressly ousted by a legislation, or by a circular, invariably they will have to be read into the provisions of the

law, especially where a decision, administrative or otherwise, would have civil consequence;

(v) In order to see whether the principles of natural justice are impliedly ousted or not, certain factors would have to be kept in mind, namely the language and the basic scheme of the provision conferring the power, the nature of the power, purpose for which it is conferred, and the effect of the exercise of the power; and

(vi) Moreover, the principles of natural justice may be impliedly ousted in cases of urgency where obligation to give notice and an opportunity of personal hearing would obstruct the taking of appropriate action, or a preventive, or remedial nature. Thus, the purpose of provision would need to be examined. But while seeing the existence of urgency, the Court is required to balance between 'hurry' and 'hearing'. Since the principles of natural justice are not contained in a straight-jacket formula, they can be adapted to urgent situations. In an urgent situation, it is not necessary to give an elaborate hearing to the affected person. The hearing can be short but substantive, prompt but effective. But it is imperative to bear in mind that even the administrative bodies must act in a just, fair and a reasonable manner. For, fair play in administrative action is the heartbeat of good governance.

34. While interpreting the Master Circular these principles would have to be borne in mind.

35. The Master Circular is entitled as "*Reserve Bank of India (Frauds Classification and Reporting by Commercial Banks and Select FIs) Directions 2016*"; the Master Circular was subsequently updated on 30.06.2017. Merely because the title of the Master Circular is "*fraud*

classification and reporting", it does not necessarily mean that the function of the JLF, and of the FIC are limited merely to discovery of fraud, and its reporting by the commercial banks. Therefore, it is imperative to delve deeply into the relevant provisions of the Master Circular in order to fully comprehend its total purport, scope and purpose.

36. The Master Circular has been issued by invoking the powers conferred under Section 35-A of the Banking Regulation Act, 1946. Thus, *ipso facto*, the Master Circular has a statutory force.

37. The purpose of the Master Circular is mentioned in Clause 1.3 as under:-

> ***1.3. Purpose**: These directions are issued with a view to providing a framework to banks enabling them to detect and report frauds early and taking timely consequent actions like reporting to the Investigative agencies so that fraudsters are brought to book early, examining staff accountability and do effective fraud risk management. These directions also aim to enable faster dissemination of information by the Reserve Bank of India (RBI) to banks on the details of frauds, unscrupulous borrowers and related parties, based on banks' reporting so that necessary safeguards / preventive measures by way of appropriate procedures and internal checks may be introduced and caution exercised while dealing with such parties by banks.*

38. A bare perusal of Clause 1.3 clearly reveals that the Master Circular has myriad purposes, namely to detect and report frauds early; to take timely consequent actions by reporting to the investigating agency; faster dissemination of information by RBI to banks on the details of the fraud by unscrupulous borrowers and related parties so that necessary safeguards/preventive measures, by way of appropriate procedures and internal checks, may be introduced and caution exercised while dealing with such parties by the banks. Thus, in short, the purpose seems to be not just to discover a fraud being committed on a bank, but also to alert the other banks to take necessary safeguards / preventive measures against such parties who may be declared as 'fraudster'. Moreover, the purpose is to initiate the investigation through investigating agencies.

39. Clause 2.2 of the Master Circular classifies frauds into different categories based merely on the provisions of the Indian Penal Code. Clause 2.2 of the Master Circular is as under:-

2. 2 Classification of Frauds

2.2.1 *In order to have uniformity in reporting, frauds have been classified as under, based mainly on the provisions of the Indian Penal Code:*

a. *Misappropriation and criminal breach of trust.*

b. *Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.*

c. *Unauthorised credit facilities extended for reward or for illegal gratification.*

d. *Cash shortages.*

e. *Cheating and forgery.*

f. *Fraudulent transactions involving foreign exchange*

g. *Any other type of fraud not coming under the specific heads as above.*

40. Clause 8.2 of the Master Circular deals with the objective of the framework. Clause 8.2 is as under:-

8.2 Objective of the framework:

The objective of the framework is to direct the focus of banks on the aspects relating to prevention, early detection, prompt reporting to the RBI (for system level aggregation, monitoring & dissemination) and the investigative agencies (for instituting criminal proceedings against the fraudulent borrowers) and timely initiation of the staff accountability proceedings (for determining negligence or connivance, if any) while ensuring that the normal conduct of business of the banks and their risk taking ability is not adversely impacted and no new and onerous responsibilities are placed on the banks. In order to achieve this objective, the framework has stipulated time lines with the action incumbent on a bank. The time lines / stage wise actions in the loan life-cycle are expected to compress the total time taken by a bank to identify a fraud and aid more effective action by the law enforcement agencies. The early detection of Fraud and the necessary corrective action are important to reduce the quantum of loss which the continuance of the Fraud may entail.

41. Clause 8.3 of the Master Circular prescribes early warning signals, and deals with Red Flag Accounts (RFA). Clause 8.3 and its Sub-clauses are as under:-

8.3 Early Warning Signals (EWS) and Red Flagged Accounts (RFA)

8.3.1 *A Red Flagged Account (RFA) is one where a suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS). These signals in a loan account should immediately put the bank on alert regarding a weakness or wrong doing which may ultimately turn out to be fraudulent. A bank cannot afford to ignore such EWS but must instead use them as a trigger to launch a detailed investigation into a RFA.*

8.3.2 *An illustrative list of some EWS is given for the guidance of banks in Annex II to this circular. Banks may choose to adopt or adapt the relevant signals from this list and also include other alerts/ signals based on their experience, client profile and business models. The EWS so compiled by a bank would form the basis for classifying an account as a RFA.*

8.3.3 *The threshold for EWS and RFA is an exposure of ₹500 million or more at the level of a bank irrespective of the lending arrangement (whether solo banking, multiple banking or consortium). All accounts beyond ₹500 million classified as RFA or 'Frauds' must also be reported on the CRILC data platform together with the dates on which the accounts were classified as such. As of now, this requirement is in addition to the extant requirements of reporting to RBI as mentioned in Para 3.2 above.*

8.3.4 *The modalities for monitoring of loan frauds below ₹500 million threshold is left to the discretion of banks. However, banks shall continue to report all identified accounts to CFMC, RBI as per the existing cut-offs.*

8.3.5 *The tracking of EWS in loan accounts should not be seen as an additional task but must be integrated with the credit monitoring process in the bank so that it becomes a continuous activity and also acts as a trigger for any possible credit impairment in the loan accounts, given the interplay between credit risks and fraud risks. In respect of large accounts it is necessary that banks undertake a detailed study of the Annual Report as a whole and not merely of the financial statements, noting particularly the Board Report and the Managements' Discussion and Analysis Statement as also the details of related party transactions in the notes to accounts. The officer responsible for the operations in the account, by whatever designation called, should be sensitised to observe and report any manifestation of the EWS promptly to the Fraud Monitoring Group (FMG) or any other group constituted by the bank for the purpose immediately. To ensure that the exercise remains meaningful, such officers may be held responsible for non-reporting or delays in reporting.*

8.3.6 *The FMG or any such designated committee shall classify the account as RFA and the details of RFA accounts shall be put up to the CMD/ CEO every month.*

8.3.7 *A report on the RFA accounts shall be put up to the Special Committee of the Board for monitoring and follow-up of Frauds (SCBF) providing, inter alia, a synopsis of the remedial action taken together with their current status.*

42. A bare perusal of Clause 8.3.1 clearly reveals that as soon as there is a suspicion of fraudulent activity, an *early warning signal* can be issued. These *early warning signals* would put the bank / financial institution on high alert, with regard to a weakness or wrongdoing by a person / entity, which may ultimately turn out to be fraudulent. According to Clause 8.3.6 of the Master Circular, the Fraud Monitoring Group ('FMG'), or any designated committee, can classify the account as RFA. Once the account is classified as RFA, the necessary information would be put up to the CMD / CEO every month. Moreover, according to Clause 8.3.7 of the Master Circular, the Report of the RFA accounts shall be placed before the Special Committee of the Board for monitoring and follow-up of frauds. Thus a complete warning system has been created to put up the concerned banks, other banks, and financial institutions on high alert.

43. In fact, Clause 8.4 of the Master Circular prescribes an elaborate procedure for early detection and reporting of frauds. The said procedure deals with checks and investigations during the different stages of the loan life, i.e. from the stage of pre-sanction, to the stage of disbursement, and to the stage of annual review. Therefore, even an elaborate system has been created for early detection and reporting. Moreover, in order to motivate the banks to report a suspicious fraudulent account promptly, an incentive has been provided by Clause 8.7 of the Master Circular.

44. While Clause 8.8 of the Master Circular deals with bank as a sole lender, Clause 8.9 deals with a consortium of banks, who have lent money to a given borrower, or with 'multiple banking' arrangements. According to Clause 8.9.2, "*all the banks, who have financed a borrower under 'multiple banking' arrangement*", should take coordinated action, based on commonly agreed strategy, for legal / criminal actions, follow up for recovery, exchange of details on *modus operandi*, achieving consistency

in data / information on frauds reported to Reserve Bank of India. Therefore, the bank which detects a fraud is required to immediately share the details with all other banks in the multiple banking arrangements.

45. According to Clause 8.9.4 of the Master Circular, "*the initial decision to classify any standard or Non-Performing Assets ('NPA') account as RFA or Fraud would be at the individual bank level. It would be the responsibility of this bank to report the RFA or Fraud status of the account on the CRILC platform so that other banks are alerted. In case it is decided at the individual bank level to classify the account as fraud straightaway at this stage itself, the bank shall report the fraud to RBI within 21 days of detection and also report the case to CBI/Police. Further within 15 days of RFA/Fraud classification, the bank which has red flagged the account or detected the fraud would ask the consortium leader or the largest lender under MBA to convene a meeting of the JLF to discuss the issue*".

46. Clause 8.9.4 of the Master Circular further prescribes that "*the meeting of the JLF so requisitioned must be convened within 15 days of such a request being received. In case there is a broad agreement, the account should be classified as a fraud; else based on the majority rule of agreement amongst banks with at least 60% share in the total lending, the account should be red flagged by all the banks and subjected to a forensic audit commissioned or initiated by the consortium leader or the largest lender under MBA*".

47. Clause 8.9.5 of the Master Circular prescribes the procedure as under:-

> ***8.9.5*** *The forensic audit must be completed within a maximum period of three months from the date of the JLF meeting authorizing the audit. Within 15 days of the completion of the forensic audit, the JLF shall reconvene and decide on the status of the account, either by consensus or the majority rule as specified above. In case the decision is to classify the account as a fraud, the RFA status shall be changed to Fraud in all banks and reported to RBI and on the CRILC platform within a week of the said decision. Besides, within 30 days of the RBI reporting, the bank commissioning/ initiating the forensic audit should lodge a complaint with the CBI on behalf of all banks in the consortium/MBA. For this purpose, if the bank initiating the forensic*

audit is a private sector bank, the complaint shall be lodged with the CBI by the PSU bank with the largest exposure to the account in the consortium/MBA. If there is no PSU bank in the consortium / MBA or it is a solo bank lending by a private sector bank/foreign bank, the private bank/foreign bank shall report to the Police as per extant instructions. This would be in addition to the complaint already lodged by the first bank which had detected the fraud and informed the consortium/MBA.

48. A bare perusal of Clause 8.9.4 and 8.9.5 of the Master Circular clearly reveal that while these provisions bestow a power upon the JLF to classify an account as 'fraud', either by consensus, or by majority rule of agreement, neither of these provisions import the applicability of principles of natural justice before the JLF decides to classify the account as 'fraud'. These provisions further impose a duty upon the JLF to report to the RBI within thirty days of their decision about classifying the account as 'fraud'. Moreover, the bank is duty bound to lodge a complaint with the CBI on behalf of all the banks in the consortium. Therefore, the moment an account is classified as 'fraud', within thirty days the classification needs to be reported to the RBI, and to the law enforcement agency in order to trigger off the criminal investigation. Moreover, according to Clause 8.9.6 of the Master Circular, "*the overall time allowed for the entire exercise to be completed is six months from the date when the first member bank reported the account as RFA or Fraud on the CRILC platform*".

49. Clause 8.11 of the Master Circular deals with filing of complaints with Law Enforcement Agencies. It is as under:-

8.11 Filing Complaints with Law Enforcement Agencies

8.11.1 *Banks are required to lodge the complaint with the law enforcement agencies immediately on detection of fraud. There should ideally not be any delay in filing of the complaints with the law enforcement agencies since delays may result in the loss of relevant 'relied upon' documents, non- availability of witnesses, absconding of borrowers and also the money trail getting cold in addition to asset stripping by the fraudulent borrower.*

8.11.2 *It is observed that banks do not have a focal point for filing CBI / Police complaints. This results in a non-uniform approach to complaint filing by banks and the investigative agency has to deal*

with dispersed levels of authorities in banks. This is among the most important reasons for delay in conversion of complaints to FIRs. It is, therefore, enjoined on banks to establish a nodal point / officer for filing all complaints with the CBI on behalf of the bank and serve as the single point for coordination and redressal of infirmities in the complaints.

8.11.3 *The complaint lodged by the bank with the law enforcement agencies should be drafted properly and invariably be vetted by a legal officer. It is also observed that banks sometimes file complaints with CBI / Police on the grounds of cheating, misappropriation of funds, diversion of funds etc., by borrowers without classifying the accounts as fraud and/or reporting the accounts as fraud to RBI. Since such grounds automatically constitute the basis for classifying an account as a fraudulent one, banks should invariably classify such accounts as frauds and report the same to RBI.*

50. Most importantly, Clause 8.12 prescribes the penal measures for fraudulent borrowers. The entire Clause is as under:-

8.12 Penal measures for fraudulent borrowers

8.12.1 *In general, the penal provisions as applicable to willful defaulters would apply to the fraudulent borrower including the promoter director(s) and other whole time directors of the company insofar as raising of funds from the banking system or from the capital markets by companies with which they are associated is concerned, etc. In particular, borrowers who have defaulted and have also committed a fraud in the account would be debarred from availing bank finance from Scheduled Commercial Banks, Development Financial Institutions, Government owned NBFCs, Investment Institutions, etc., for a period of five years from the date of full payment of the defrauded amount. After this period, it is for individual institutions to take a call on whether to lend to such a borrower. The penal provisions would apply to non-whole time directors (like nominee directors and independent directors) only in rarest of cases based on conclusive proof of their complicity.*

8.12.2 *No restructuring or grant of additional facilities may be made in the case of RFA or fraud accounts. However, in cases of fraud/malfeasance where the existing promoters are replaced by new promoters and the borrower company is totally delinked from such erstwhile promoters/management, banks and JLF may take a view on restructuring of such accounts based on their viability, without prejudice to the continuance of criminal action against the erstwhile promoters/management.*

8.12.3 *No compromise settlement involving a fraudulent borrower is allowed unless the conditions stipulate that the criminal complaint will be continued.*

8.12.4 *In addition to above borrower- fraudsters, third parties such as builders, warehouse/cold storage owners, motor vehicle/tractor dealers, travel agents, etc. and professionals such as architects, valuers, chartered accountants, advocates, etc. are also to be held accountable if they have played a vital role in credit sanction/disbursement or facilitated the perpetration of frauds. Banks are advised to report to Indian Banks Association (IBA) the details of*

such third parties involved in frauds.

8.12.5 *Before reporting to IBA, banks have to satisfy themselves of the involvement of third parties concerned and also provide them with an opportunity of being heard. In this regard the banks should follow normal procedures and the processes followed should be suitably recorded. On the basis of such information, IBA would, in turn, prepare caution lists of such third parties for circulation among the banks.*

51. A holistic analysis of the Master Circular clearly reveals that although it is important to report the discovery of a fraud to the RBI, although it is essential to initiate the criminal investigation within a short period, but nonetheless, a sufficient '*warning signal system*' is built into the system, so as to alert not only the banks forming the Consortium, not only the RBI, but also the other banks. Therefore, the argument raised by Mr. B. S. Prasad, and Mr. B. Nalin Kumar that, unless urgency is shown in declaring a borrower as a fraudulent borrower, the entire banking organization may be exposed to further fraud by a borrower, is bereft of any merit. For, firstly, there is an inbuilt system for early detection and reporting of possible fraud. There is a system for checks / investigations during the different stages of loan life cycle – beginning with the pre-sanction, disbursement and annual review. Secondly, once a suspicion arises that there is some fraudulent activity, *early warning signals* can be triggered off putting the rest of the banks on high alert, while dealing with an alleged fraudulent borrower. Thirdly, an account can be declared as RFA by the Fraud Monitoring Group. Therefore, a complete safety system has been prescribed by the Master Circular. Hence, the contention that urgency demands that principles of natural justice should not be read into the Master Circular, is a fallacious contention.

52. As mentioned hereinabove, even an administrative functionary / body, like the JLF, would have to balance the twin aspects of 'hurry' and 'hearing'. Therefore, the principles of natural justice can be modified to an emergent situation. Instead of having an elaborate hearing

proceeding, the proceeding can be short but substantive, prompt but effective. Undoubtedly, the JLF needs to form an opinion whether the borrower is playing fraud on the bank or not? Obviously, evidence needs to be placed before the JLF for it to formulate its opinion. Therefore, the evidence to be read against a party needs to be furnished to the party. The party has to be given an opportunity to explain, or to challenge the evidence. Thus, the argument of urgency cannot be accepted for jettisoning the applicability of principles of natural justice.

53. Even on factual matrix, the argument of urgency is belied by the record. For, the Company's account was declared as NPA on 29.06.2016; the JLF declared the Company's account as fraud on 15.02.2019, yet the FIC did not declare the Company's account as fraud till 31.07.2019. Thus, there is a gap of 4 ½ months between the decision of the JLF and the FIC. Hence, obviously, the decision to declare the account as fraud has not been taken on an 'urgent' basis.

54. Furthermore, if the requirement of principle of nature justice is not read into the Master Circular, it would suffer from vagueness. For, on the one hand, Clauses 8.9.4 and 8.9.5 of the Master Circular *prima facie* seem to deny the opportunity of hearing to the borrower. Yet, Clause 8.12.1 of the Master Circular clearly states that the procedure for declaring a borrower as a willful defaulter has to be followed. In the case of **Jah Developers** (supra), the Hon'ble Supreme Court has already declared that prior to declaring a borrower as a willful defaulter, an opportunity of hearing has to be given. If the principle of *audi alteram partem* were not read into Clauses 8.9.4 and 8.9.5 of the Master Circular, there would be a contradiction between the procedure adopted for declaring a borrower as 'a willful defaulter', and the procedure adopted for declaring an account as 'fraud'. Obviously, the Master Circular could not speak in self-contradictory terms. Therefore, to erase the self-contained contradiction, and to save the Master Circular from the virus of

vagueness, the principles of natural justice perforce would have to be read into Clauses 8.9.4 and 8.9.5 of the Master Circular.

55. According to the Apex Court, another factor to be applied is to examine the consequences of the decision, in order to decipher if the principles of natural justice are ousted by the law or not? Hence, this Court is further required to examine the consequences of the decision of the JLF. A bare perusal of the provisions mentioned above, clearly reveal that according to Clause 8.12 of the Master Circular, both the fraudulent borrower and the Promoter/Director(s), and other whole time Director(s) would be debarred from raising funds from banking system for a period of five years. Moreover, they will be debarred from restructuring, or from seeking additional funds. Furthermore, they will be debarred from entering into a compromise or settlement. Therefore, their access to financial institutions, at least for a period of five years, would totally be cut off. Even after five years, it is for the financial institutions to decide whether to lend any finances, to such a person or entity or not? Thus, once branded as 'a fraudster', or 'a fraudulent borrower', or 'holder of a fraud account', the stigma will continue for a considerable time. Needless to say, such a stigma would prevent the Promoter / Director from establishing any other enterprise, or project, or business. Such a stigma would, thus, adversely affect the fundamental rights of a Promoter / Director to carry on a trade or a business, which is guaranteed under Article 19(1)(g) of the Constitution of India. Therefore, such a classification would have "grave civil consequences" for Promoter / Director of a borrowing Company.

56. Further, since the right to livelihood is part and parcel of fundamental right to life under Art. 21 of the Constitution of India, the fundamental right can be deprived only by a reasonable procedure established by law. However, to deny the said fundamental right without giving an opportunity of hearing would be highly unreasonable, unfair and

unjust. Thus, the Master Circular, as interpreted by the RBI, would be in violation of Article 21 of the Constitution of India. Therefore, to save Clauses 8.9.4 and 8.9.5 of the Master Circular from being declared as unconstitutional, it is essential to read the principle of natural justice into the said Clauses.

57. Furthermore, since the Master Circular also imposes a duty on the banks to lodge a complaint with the CBI / criminal investigating agency within a short period, after detecting / declaring an account as 'fraud', obviously, the borrowing Company, its Promoter / Director would quickly be embroiled in criminal investigation and in criminal proceedings. Such involvement in criminal proceedings not only affects the social standing of an individual and the goodwill of a Company, but also forces an individual to spend money, to invest energy, and to go through the rigmarole of a criminal trial. Therefore, the classification of an account as 'fraud' has devastating impact on the life of a person. Yet, Clauses 8.9.4 and 8.9.5 of the Master Circular, which deal with the decision-making process of a JLF, which deal with the declaration of an entity or a person as a holder of a fraudulent account, is absolutely silent about giving an opportunity of hearing to the adversely affected party. Thus, considering the grave consequences of the decision, considering the grave impact on the fundamental rights of the Directors, the principles of natural justice must be read into the said Clauses.

58. Moreover, if an opportunity of hearing were not to be read into the Master Circular, then the power bestowed under Clauses 8.9.4 and 8.9.5 of the Master Circular is an unbridled power given to the JLF for declaring a person / Company as 'a fraudulent borrower'. Such an absolute power could not be intended by the RBI while promulgating the Master Circular. For, absolute power corrupts absolutely. Therefore, such unfettered power needs to be cribbed, cabined and confined within known limits placed by law. The principles of natural justice are one of the

best known contours of law for limiting arbitrary power. Furthermore, in case principles of natural justice were not read into Clauses 8.9.4 and 8.9.5 of the Master Circular, these provisions would be violative of Article 14 of Constitution of India. For, arbitrary action is an anathema to the notion of fairness and reasonableness. Hence, perforce the principles of natural justice, especially the principles of *audi alteram partem* would have to be read into Clauses 8.9.4 and 8.9.5 of the Master Circular.

59. Ironically, the 'right to be heard' has been given to third parties, such as builders, warehouse/cold storage owners, motor vehicle/ tractor dealers, travel agents, etc. and professionals such as architects, valuers, chartered accountants, advocates, etc., if they have played a vital role in sanction/disbursement, or facilitated for preparation of fraud. Hence, while those who are allegedly the peripheral accomplices are granted an opportunity of hearing, the main actor is denied the right to speak and to defend his position. Considering the grave civil consequences and penal action, which would be followed as a result of classifying a borrower as 'a fraudulent borrower', or 'a holder of a fraudulent account', it is imperative that principles of natural justice must be read into Clauses 8.9.4 and 89.9.5 of the Master Circular.

60. Fair play in governance is the gravitational force which binds the entire State. Therefore, before a person or entity is obliterated, or is subjected to civil and penal consequences, the person or entity must be given an opportunity of hearing. Without giving an opportunity of hearing, without giving an opportunity to explain the intricacies of the accounts, or of the business dealings, to denounce a person is to act unfairly, unjustly, unreasonably, and arbitrarily. Even in an administrative action, justice should not only be done, but also must appear to be done to the satisfaction of all the parties. Therefore, the principles of *audi alteram partem*, howsoever short, have to be applied before declaring a party as 'a fraudulent borrower', or as 'a holder of fraudulent account'. Such an

interpretation is also inconsonance with the principles extracted above from the relevant case law. Thus, this Court is of the opinion that the principles of *audi alteram partem* will have to be incorporated into Clauses 8.9.4 and 8.9.5 of the Master Circular even if the said Clauses are silent. Such an interpretation cannot be said to be farfetched. For, as mentioned above, in a series of cases decided by the Apex Court, the Hon'ble Supreme Court has read the requirements *audi alteram partem* even in those provisions of law which did not expressly prescribed the observance of *audi alteram partem* in their scope and ambit.

61. According to Mr. B. Nalin, the learned Standing Counsel for the RBI, lodging of a complaint is similar to registration of an FIR. Therefore, the need to hear the alleged accused prior to initiating the criminal investigation cannot be read into the Master Circular. In our view, the said argument is highly misplaced. For, the first step is for the JLF to form an opinion whether the borrower is 'a fraudulent borrower' or not, or whether the account is 'a fraud' or not? It is only after formulating the said opinion, that the JLF is required to lodge a complaint with the criminal investigating agency. Moreover, since the very formation of an opinion would instantaneously trigger off civil and penal consequences, the formation of an opinion cannot be equated with the lodging of an FIR. Therefore, the contention raised by Mr. B. Nalin, is clearly unacceptable.

62. Coming to the factual aspects of the case, Mr. Mukul Rohatgi, the learned Senior Counsel, has pleaded that prior to the meeting of the JLF dated 15.02.2019, the Company was invited to all the earlier meetings of the JLF. Yet, while taking the most crucial decision, the Company has been kept at bay. This assertion of the petitioner has not been denied by the respondents. Hence, the assertion is taken to be true. Since the Company was invited and participated on the earlier occasion, then the Company cannot be denied the opportunity of hearing on the spacious plea that Clauses 8.9.4 and 8.9.5 of the Master Circular do not envisage

the giving of opportunity of hearing to the defaulting party. To raise such a plea is to approbate and reprobate simultaneously. Hence, the denial of opportunity of hearing to the petitioner or to the Company is legally unsustainable.

63. A bare perusal of the decision taken by the JLF in its meeting on 15.02.2019, and the resolution by the FIC on 31.07.2019 clearly reveal that the JLF and the FIC have relied upon the Report of the Forensic Auditor, dated 06.04.2018. Moreover, FIC has relied upon the Report submitted by Dr. K.V. Srinivas, IRP, for concluding that the account of the borrowing Company should be declared as 'fraud'. According to Mukul Rohatgi, copies of these reports were never furnished, either to the borrower Company, or to its Directors such as the petitioner. It is, indeed, trite to state that a party must be informed about the evidence which is likely to be used against it. For, a chance to meet out the evidence, to challenge the same has to be given to the party. However, even this rudimentary principle has been ignored by the JLF. Thus, the decision dated 15.02.2019 of the JLF is legally unsustainable.

64. Mr. B.S. Prasad, the learned Senior Counsel, has of course argued that the IDBI Bank in its letter, dated 21.04.2018, had furnished a copy of the Forensic Auditor's Report. However, the said contention is belied by the record. For, in its letter dated 21.04.2018 the IDBI Bank had merely extracted and paraphrased the finding of the Forensic Auditor Report. But the complete copy of the Forensic Auditor Report was never submitted along with the said letter. Hence, the Company was denied the opportunity to explain the finding of the Report, and the opportunity to challenge the findings of the Report.

65. Moreover, the Report submitted by Dr. K.V. Srinivas, IRP, relied on by the FIC was never brought to the notice of, either the borrower Company, or to its Directors. Thus, neither the borrower Company, nor the petitioner had any information, or knowledge about a

report which was going to be read against them. It is, indeed, trite to state that a piece of evidence which would be read against a party must necessarily be brought to the notice of the party. For, a full opportunity needs to be given to the concerned party to explain, or to challenge the evidence being read against him/it. However, this crucial step which is part of *audi alteram partem* is conspicuously missing in the present case.

66. A bare perusal of the order, dated 15.02.2019, clearly reveals that, according to Item No. 2, having considered the Report of the Forensic Auditor, and on perusal of the clarification / information submitted by the Company to the Forensic Auditor, the JLF had agreed to '*close the observation'*. Similarly, in Item No. 4, the Auditor's Report, with regard to the Fund Flow Statement, the JLF had decided to '*close the observation*'. Likewise, according to Item No. 5, dealing with payment of advances to M/s. Rohit Iron and Steel (I) Pvt. Ltd., the JLF had considered the Forensic Auditor's Report and agreed to *"close the observations*". Thus, the *observations* were closed not only on the basis of the Forensic Auditor's Report, but also on the basis of clarification / information submitted by the Company to the Forensic Auditor. Yet, the same opportunity to explain to the JLF was not given to the Company, or to the petitioner. Hence, the decision of the JLF dated 15.02.2019 is legally invalid.

67. Moreover, according to Item No. 1, further clarification was sought from the Forensic Auditor. Similarly, according to Item No. 3, a further clarification was sought from the Forensic Auditor. Likewise, according to Item No. 8, further clarification was to be obtained from Forensic Auditor. Yet, the JLF did not wait for further clarification from the Forensic Auditor. Instead, instantaneously the JLF, in its meeting, unanimously decided that *"the account be treated as fraud*". Interestingly, according to Item Nos. 1, 3 and 8, the JLF had also decided that *"in case no clarification is received from the Forensic Auditor, only then it will treat*

the account as fraud". Yet, curiously, it had not waited to receive further clarification from the Forensic Auditor, but has jumped to the conclusion that *"the account be treated as fraud*". Hence, the JLF has drawn conclusion in absence of the relevant evidence. Therefore, the conclusion is legally unsustainable.

68. The final conclusion of the JLF reads as under:-

> *"Hence, it was unanimously decided that the account be treated as fraud for the above reasons*".
>
> (Emphasis added)

Once the JLF was of the opinion that further clarification is required from the Forensic Auditor, once it is in the process of taking a decision, once it has decided to wait till further clarification is submitted, the JLF is not justified in concluding that *"the account be treated as fraud*". In fact, the JLF was legally required to wait for further clarification, or non-clarification from the Forensic Auditor. But till it had heard from the Forensic Auditor, one way or the other, it could not have jumped the gun. Moreover, the JLF is unjustified in claiming that '*the account is treated as fraud for the above reasons*". After all, the reasons themselves are incomplete and inchoate as the JLF had already opined that '*further clarification from the Forensic Auditor should be called for*'. Therefore, the use of the words "*for the above reasons*", are merely the use of a legalistic language without any substantive content. Hence, the final conclusion of the JLF has the veneer of a legal reasoning, but is deprived of legal content. Therefore, the decision of the JLF is legally unsustainable.

69. A bare perusal of the resolution of FIC, dated 31.07.2019, also reveals that the said resolution is based on the Report submitted by Dr. K.V. Srinivas, IRP. However, there is no evidence available on record to establish the fact that a copy of the said Report was furnished to the borrower Company, or to the petitioner. Thus, neither the borrower Company, nor the petitioner, nor any other Director was given a chance to explain, or to challenge the finding of the said Report. A copy of the said

Report has not been placed even before this Court by the respondents. Therefore, the decision taken by FIC is again based on a piece of evidence, which was never brought to the notice of the borrower Company, or to the notice of the petitioner. Therefore, a vital requirement of *audi alteram partem* is conspicuously missing. Therefore, the resolution of the FIC, dated 31.07.2019 is legally unsustainable.

70. For the reasons stated above, this Writ Petition is, hereby, allowed with the following directions and in the following terms:-

70.1. Firstly, the principle of *audi alteram partem*, part of the principles of natural justice, is to be read in Clause 8.9.4 and 8.9.5 of the Master Circular.

70.2. Secondly, the decision, dated 15.02.2019, passed by the JLF, and the resolution dated 31.07.2019, passed by the FIC are, hereby, set aside.

70.3. Thirdly, the JLF is directed to give an opportunity of hearing by furnishing copies of both the Reports, namely the Forensic Auditor Report, dated 06.04.2018 and the subsequent Report submitted by Dr. K.V. Srinivas, IRP, to the petitioner, and to the OL.

70.4. Fourthly, the JLF is directed to give an opportunity of personal hearing both to the petitioner and to the OL before taking any decision on the issue whether the account should be classified as 'fraud' or not?

70.5. Fifthly, after the JLF has taken its decision, the FIC is directed to pass its resolution whether the decision of the JLF should be confirmed or not?

70.6. Lastly, the said exercise shall be carried out by the JLF within a period of three months from the date of receipt of the certified copy of this judgment. Furthermore, the subsequent exercise by FIC shall be carried out within two months from the date of the decision of the JLF.

Miscellaneous Petitions, pending if any, shall stand closed. No order as to costs.

RAGHVENDRA SINGH CHAUHAN, CJ

B. VIJAYSEN REDDY, J

December 10, 2020

Note:
L.R. Copy to be marked
Tsr

THE HON'BLE THE CHIEF JUSTICE RAGHVENDRA SINGH CHAUHAN
AND
THE HON'BLE SRI JUSTICE B. VIJAYSEN REDDY

WRIT PETITION NO.19102 OF 2019

(Per the Hon'ble the Chief Justice Raghvendra Singh Chauhan)

Date: 10-12-2020

Tsr