Ratul Puri vs Bank Of Baroda on 29 February, 2024

Author: Purushaindra Kumar Kaurav

Bench: Purushaindra Kumar Kaurav

2024:DHC:1640

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* IN THE HIGH COURT OF DELHI AT NEW DELHI
BEFORE
HON'BLE MR. JUSTICE PURUSHAINDRA KUMAR KAURAV
+ W.P.(C) 4181/2023 & CM APPLs.16200/2023 & 46302/2023

Between:-

RATUL PURI
S/O MR. DEEPAK PURl
A-187 NEW FRIENDS COLONY
NEW DELHI 110025

ALSO AT:
H.NO. 2 VILLAGE MANAGANJ WARD NO.11
JAITHARI, ANUPPUR,
MADHYA PRADESH- 484330 ..... PETITIONER

(Through: Mr. Dayan Krishnan, Senior Advocate with Mr. Vaibhav Mishra, Mr. Karan Batura, Mr. Ekansh Mishra and Mr. Jayant Chawla, Advocates)

AND

BANK OF BARODA
THROUGH GENERAL MANAGER
SH. V.K. KHANDELWAL
STRESSED ASSETS MANAGEMENT BRANCH
4TH FLOOR, RAJENDRA BHAWAN,
RAJENDRA PLACE, NEW DELHI- 110 008

THROUGH ITS NOMINATED COUNSEL
MR. KUSH SHARMA
KSA LAW OFFICES LLP
CHAMBER: 385, BLOCK-II,
DELHI HIGH COURT

NEW DELHI-110003 ..... RESPONDENT

(Through: Mr. Chinmoy Pradip Sharma, Senior Advocate alongwith Mr. Kush Sharma, Standing Counsel and Mr. Nishchaya Nigam, Advocate)

% Pronounced on: 29.02.2024

JUDGMENT

1. This writ petition is filed by the petitioner under Article 226 of the Constitution of India challenging the validity of the impugned order dated 23.3.2023 passed by the Review Committee of the Respondent i.e., the Bank of Baroda ("respondent-Bank"), whereby, the decision dated 19.8.2022 taken by the Committee of Executives ("CoE"), declaring the petitioner as wilful defaulter under the "Master Circular on Wilful Defaulters, 2015" ("Master Circular"), issued by the Reserve Bank of India ("RBI"), was confirmed.

FACTS OF THE CASE

2. It is stated that the petitioner is the Chairman of Hindustan Power Projects Pvt. Ltd., which runs a 1200 mega-watt power plant and supplies electricity to three States namely, Uttar Pradesh, Madhya Pradesh and Haryana. Petitioner s company has availed loan facilities amounting to thousands of crores and it is stated that there has never been any default in servicing the debt since inception.

3. However, it is alleged that the respondent-Bank sought to declare the petitioner as a wilful defaulter with respect to his association in another company known as Moser Baer India Ltd. ("MBIL") under the Master Circular, thereby, depriving the petitioner from availing credit facilities for his present and prospective business enterprises.

4. It is stated that MBIL was founded in 1983 by the father of the petitioner namely, Mr. Deepak Puri. MBIL diversified into manufacturing of floppy diskettes, CDs and DVDs. Between 1993 to 2005, it was the second largest disk manufacturer in the world. During 2000-2004, Warburg Pincus Group ("WPG") invested in MBIL and a Shareholder s Agreement dated 17.6.2000 was executed, which had a condition that the petitioner shall be a Director of MBIL till the time WPG is a shareholder in MBIL. Accordingly, the petitioner became a Director of MBIL on 19.7.2000, which is reflected in Form-32 filed by MBIL with the Registrar of Companies ("RoC").

5. It is the case of the petitioner that MBIL flourished as the business of CDs and DVDs was a lucrative business. However, with the emergence of newer platforms of storage, CDs and DVDs started becoming obsolete and could not sustain the growth trajectory.

6. It is stated that in order to look for more financially viable fields, MBIL entered into other forays

and formed two subsidiaries namely, Moser Baer Photo Voltaic Limited ("MBPV") (now known as Helios Photo Voltaic Limited) in 2005 and Moser Baer Solar Limited ("MBSL") in 2007, respectively. These companies were created to manufacture solar cell modules which was upcoming technology as countries attempted to move towards clean energy. The solar business of the subsidiaries was valued at more than USD 1 billion and several investors invested in the same with investments of around USD 193.50 million from global investors like IDFC, Nomura, Morgan Stanley, GIC, CDC etc. under two Investor Agreements.

7. In 2006, MBIL had availed a loan facility from the respondent- Bank and certain other banks. The respondent-Bank had sanctioned the loan facility by sanction letters dated 12.12.2006 and 24.4.2010.

8. It is stated that the global financial crisis in the year 2007 and the dumping of solar panels by Chinese companies severely impacted the business of MBIL and its subsidiaries. Several applications were filed seeking imposition of anti-dumping duties. The Directorate of Anti-Dumping in India made a recommendation to the Government to impose anti-dumping duties against Chinese companies to the extent of 70%. However, Government of India chose not to do so as its aim was to provide electricity at cheaper rates in India in consumers favour. This led to Indian manufacturers of solar panels like MBIL s subsidiaries MBPV and MBSL to suffer financially.

9. It is stated that the petitioner started to have disagreements with his father over the business strategies around 2008. In the year 2010, pursuant to a family arrangement, the petitioner decided to exit from MBIL to focus on the thermal energy business. It is stated that while the petitioner had stopped being actively involved in the Moser Baer group of companies, he continued to remain a Director on the Board in MBIL in view of the condition incorporated in the Shareholder s Agreement with WPG.

10. As the profits of MBIL started to decline and there was a looming threat of loan repayment default, lenders of MBIL found MBIL s case fit for admission for restructuring and accordingly, a meeting of all the lenders was held, called as Joint Lenders Meet ("JLM") on 3.2.2012, wherein, all the lender banks of MBIL including the respondent-Bank participated. In the said meeting, the MBIL representative gave a financial summary and stated that considering the precarious financial condition of MBIL, it was difficult to meet the loan obligations. MBIL placed a re-structuring plan to all the lenders. The lenders noted that in case the term debts are not restructured, MBIL would default in meeting its loan re-payment obligations. Hence, it was considered appropriate that MBIL be admitted for a Corporate Debt Restructuring ("CDR") in accordance with the CDR Master Circular ("CDR Master Circular") issued by the RBI. To ascertain the sustainability of CDR, the lenders required MBIL to submit a Flash Report, which would present the reasons for its decline, its viability and plan for revival. The said Flash Report would then be forwarded by the lenders to an independent agency for obtaining a Techno Economic Viability ("TEV") Report. The TEV Report would indicate whether the restructuring plan proposed by MBIL was financially viable or not. It was further decided that the lender banks would get conducted a Stock Audit of MBIL.

11. In terms of the aforesaid meeting, on 18.2.2012, MBIL submitted its Flash Report to the CDR Cell of the lender banks. One of the reasons outlined in the Flash Report in Clause 13(d) for the current financial problems of MBIL was the inability of MBIL to realize the investments made in its two subsidiaries. The Flash Report also gave details of MBIL issuing FCCB (Foreign Currency Convertible Bonds) of USD 150 million in tranches from June 2007; the brief description of its group companies, including produces and installed capacities, remarks on past track record etc. and its justification for restructuring.

12. The CDR-Empowered Group ("CDR-EG"), on 24.2.2012, decided to admit the proposal of MBIL for restructuring. MBIL was placed in Class-B category under the CDR Scheme, which has Classes from A to D. In the Class-B category, the MBIL was classified as □Corporate/promoters affected by external factors and also having weak resources, inadequate vision and not having support of professional management. Class-C is assigned to those corporates who □diverted funds to unrelated fields with or without lenders permission.

13. In the meantime, MBIL, on 4.4.2012, informed the Central Bank of India ("Central Bank"), which is the monitoring bank on behalf of the lenders, that the petitioner is no longer associated with the day to day functioning of MBIL. His association was till WPG remained invested in MBIL. Since WPG had exited MBIL on 16.3.2012 and the Shareholder s Agreement was terminated and pursuant to family arrangement of 2010, the petitioner has exited MBIL, the CDR proposal submitted by MBIL may be considered taking into account the fact that the petitioner was no longer a promoter of MBIL.

14. On 30.4.2012, the petitioner resigned as Executive Director of MBIL and submitted Form 32 with the RoC to that effect. Concurrently, the petitioner also ceased to be a shareholder of MBIL and transferred his shareholding to his father.

15. The Flash Report submitted by MBIL was sent by the lender banks to an external agency Ernst & Young for examination, which gave its detailed TEV Report dated 9.6.2012, inter alia, stating that assuming stable business and economic conditions, the MBIL may be considered viable.

16. On 16.6.2012, the RRCA & Associates ("RRCA") also submitted their Stock Audit Report to the lender banks. The RRCA, in its report, concluded that the stock as per records was verified with the physical stock at warehouses and the same was in agreement with the records.

17. On 16.7.2012, MBIL addressed another letter to Central Bank, inter alia, reiterating that the petitioner has exited MBIL and does not participate in the affairs of MBIL.

18. On 20.7.2012, a Joint Lenders Meet ("JLM") was held between all the lender banks including the respondent-Bank. In the said meeting, the MBIL informed the banks that there were constraints in realizing the investments made in its subsidiaries due to the financial stress. Various aspects of the restructuring proposal were discussed in the meeting.

19. After considering the Flash Report submitted by the petitioner; the TEV Report submitted by Ernst & Young and the Stock Audit Report submitted by RRCA, the CDR-EG, which comprised of all the lenders, issued a Final Restructuring Scheme ("FRS") dated 20.7.2012.

20. In accordance with the FRS issued by the lender banks, MBIL and the consortium of banks, including the respondent-Bank and with Central Bank as the Monitoring Institution, signed a "Master Restructuring Agreement" ("MRA") dated 27.12.2012, seeking to implement the CDR package agreed between the parties. Under the said MRA, the liabilities of MBIL were restructured by the lender banks. Clause 6.1(iv) of the MRA required the MBIL to execute a Trust and Retention Account Agreement ("TRA"). The MBIL after the execution of TRA was required to transact, for its day to day functioning, only through the TRA Account.

21. Subsequently, on 16.11.2012, the petitioner resigned as the Director of MBIL and Form 32 to that effect was filed with the RoC. As on the said date, the petitioner ceased to be a Director of MBIL, which constituted a complete exit for the petitioner from MBIL.

22. On 12.2.2013, the TRA was executed between the lender banks and MBIL.

23. After the CDR scheme, MBIL continued to operate its business. However, MBIL could not financially sustain itself and committed default in repayment of the loan amount.

24. On 25.10.2015, the Punjab National Bank ("PNB"), which was one of the lender banks to MBIL and part of CDR, issued a show cause notice to the petitioner, alleging that MBIL has defaulted in its repayment of loan obligations. It was alleged that the proceeds of business have been siphoned off and diverted. Hence, the petitioner was proposed to be classified as a wilful defaulter under the Master Circular.

25. Against the aforesaid show cause notice, the petitioner filed Writ Petition (C) No.7797/2017 before this Court. When the said Writ Petition was taken up for hearing on 14.11.2017, the Advocate for Punjab National Bank ("PNB") placed on record a communication dated 9.11.2017, issued by PNB, stating that it is not pursuing any action against the petitioner. In view of the said statement, the Writ Petition was not pressed and disposed of.

26. On 31.12.2015, the State Bank of Bikaner & Jaipur ("SBBJ"), another lender bank, issued a show cause notice to the petitioner seeking to declare the petitioner as wilful defaulter under the Master Circular. One of the allegations in the show cause notice was that MBIL had made investments in its subsidiaries. The petitioner gave his reply to the said show cause notice. After considering the same, the SBBJ vide its order dated 19.5.2016, accepted the explanation put forth by the petitioner and dropped the proceedings seeking to declare the petitioner as a wilful defaulter.

27. On 10.10.2016, the lender banks decided to exit from the CDR scheme approved for MBIL on account of failure of the said CDR scheme and inability of MBIL to meet loan repayment obligations.

28. In 2017, one of the financial creditors namely, Alchemist Asset Reconstruction Co. Ltd., filed an application under Section 7 of the Insolvency & Bankruptcy Code, 2016 ("IBC") before the National Company Law Tribunal ("NCLT") seeking to trigger the Corporate Insolvency Resolution Process ("CIRP") of MBIL. The NCLT vide its order dated 14.11.2017, appointed Mr. Anil Kohli as the Interim Resolution Professional.

29. The Resolution Professional appointed by the NCLT directed GSA Associates, Chartered Accountants ("GSA Associates") to conduct a forensic audit of MBIL. The GSA Associates gave its Forensic Audit Report dated 3.6.2019.

30. On 13.3.2020, the respondent-Bank issued a show cause notice to the petitioner as to why he should not be declared as a wilful defaulter under the Master Circular, which is the subject matter of present Writ Petition. The show cause notice made six allegations of wilful default by the petitioner. The allegation no.1, with which this case is concerned, was that "MBIL has made substantial investment in subsidiaries and related entities amounting to Rs.1586.75 Cr as on 31.12.13. During the period from 01.04.13 to 31.03.15 provision and write off made amounting to Rs.287.03 Cr."

31. The petitioner, on 30.3.2020, gave his reply stating that he resigned as the Director of MBIL on 16.11.2012 and is no longer associated with the said company. The petitioner contended that the show cause notice was issued eight years after him ceasing to be a Director of MBIL and the proposed action of declaration of petitioner as wilful defaulter was being made without supplying the necessary documents to the petitioner.

32. On 12.8.2020, the petitioner submitted another reply stating that the petitioner could not be declared as wilful defaulter for the events that have transpired after he resigned as the Director of MBIL.

33. The respondent-Bank gave a notice dated 31.10.2020 to the petitioner for a personal hearing in respect of the proceedings against him. The petitioner challenged the said letter before this Court by filing Writ Petition (C) No.8730/2020. This Court, vide order dated 6.11.2020, disposed of the said Writ Petition by directing that the respondent-Bank shall provide the necessary documents to the petitioner, as may be desired by him during the personal hearing.

34. Subsequently, certain further communications took place between the petitioner and the respondent-Bank with regard to personal hearing, which is not necessary to be delved into in detail.

35. The respondent-Bank, at the request of the petitioner, furnished a copy of the Forensic Audit Report to the petitioner on 11.1.2021. On 2.6.2021, the petitioner replied stating that he had received a copy of the Forensic Audit Report. He contended that the said report did not disclose any event of wilful default by the petitioner.

36. The respondent-Bank conducted a personal hearing on 5.8.2021. After the personal hearing, the petitioner, on 4.9.2021, filed his written submissions. In the said written submissions, the petitioner gave his response to each of the six allegations of alleged wilful default enumerated in the show

cause notice. With regard to allegation no.1, the petitioner stated that the investments in the subsidiaries were made from the internal accruals of MBIL and not from borrowed funds. The same was disclosed in the audited financial statements to the banks.

37. The petitioner filed Writ Petition (C) No.12736/2022 before this Court. However, the same was disposed of vide order dated 8.9.2022, in view of the order dated 19.8.2022 passed by the Identification Committee of the respondent-Bank during the pendency of the Writ Petition declaring the petitioner as a wilful defaulter under the Master Circular. This Court granted time to the petitioner to make a representation before the Review Committee against the order dated 19.8.2022, passed by the Identification Committee.

38. In the order dated 19.8.2022, the Identification Committee of the respondent-Bank exonerated the petitioner from alleged acts of wilful default with regard to allegation nos.2 to 6 made in the show cause notice. The Identification Committee held that the said allegations pertained to a period after the petitioner ceased to be a Director of MBIL.

39. However, with respect to allegation no.1, the Identification Committee observed that the petitioner was a whole time Director in MBIL. He was in complete control over the said company. When he felt that MBIL was in trouble; he took an easy route to exit the company. The petitioner was aware about the affairs of MBIL and the entire siphoning/ diversion of funds took place during this period. The CDR that was done subsequently, was only an attempt by the lender banks to revive MBIL. The Identification Committee ultimately held that substantial investments were made in the subsidiaries of MBIL from the account of MBIL, which triggered a shortage of funds. This action amounted to diversion of funds as per Clause 2.1.3(b) and (c) of the Master Circular. Accordingly, the petitioner was declared as a wilful defaulter. Against the said order, the petitioner could file an appeal/representation before the Review Committee of the respondent- Bank as per the Master Circular.

40. The petitioner, on 22.9.2022, filed a review representation before the Review Committee. In the said representation, the petitioner contended that the Identification Committee has committed an error in declaring him a wilful defaulter attributing the investment in subsidiaries of MBIL as diversion of funds from the Master Circular. It was reiterated that the investments in the subsidiaries were made from the internal accruals of MBIL and not from borrowed funds. The investments were disclosed in the audited financial statements to the banks. The said investments were in knowledge of the lender banks at the time of finalisation of the CDR and no objection by any lender bank was raised.

41. During the pendency of the proceedings before the Review Committee, the petitioner filed Writ Petition (C) No.1674 of 2023 before this Court against the order dated 19.8.2022. This Court, vide order dated 20.2.2023, declined to entertain the said Writ Petition. It was, however, directed that if the Review Committee confirms the order passed by the Identification Committee, the name of the petitioner shall not be published as wilful defaulter for a period of one week enabling the petitioner to avail legal redress against the same.

42. On 23.3.2023, the Review Committee passed the impugned order confirming the order passed by the Identification Committee and rejected the representation filed by the petitioner. The present Writ Petition has been filed by the petitioner assailing this order dated 23.3.2023, passed by the respondent-Bank. The prayer in the present Writ Petition is as under:

> ☐a. Issue a writ/ order/ direction of mandamus and/or certiorari quashing/ setting aside the Order passed by the Review Committee of the Respondent Bank in its meeting held on 23.03.2023 (impugned order), by which order it has arbitrarily, unfairly and unreasonably declared the name of the Petitioner as a Wilful Defaulter;
>
> b. Issue a writ/ order/ direction prohibiting the Respondent and or/its servants, agents, assigns and officers and/or anyone claiming through or under them from giving effect and/or further effect and/or taking any steps and/or acting in furtherance of the Review Committee Order dated 23.03.2023, in any manner whatsoever.

43. This Court, after hearing learned counsel for the parties, vide interim order dated 29.3.2023 stayed the operation of the impugned order dated 23.3.2023 as against the petitioner.

44. At the time of the final arguments, this Court, vide order dated 28.11.2023, had directed the parties to place on record the document which showed the satisfaction arrived at by the respondent-Bank to issue show cause notice to the petitioner. On 16.12.2023, a compilation annexing Minutes of Meeting dated 24.2.2020 was placed on record, wherein, the decision to issue show cause notice to the petitioner was taken. The said compilation is taken on record.

45. I have heard the learned counsel appearing on behalf of the parties and perused the record.

SUBMISSIONS OF THE PARTIES

46. Mr. Dayan Krishnan, learned senior counsel appearing for the petitioner, alongwith Mr. Vaibhav Mishra, Mr. Karan Batura, Mr. Ekansh Mishra and Mr. Jayant Chawla, Advocates, has made the following submissions:

> i. On account of differences with his father, who was the promoter of MBIL, the petitioner had decided to exit from MBIL in 2010 itself pursuant to a family arrangement. The said decision could not be immediately acted upon in view of the provision in the Shareholder s Agreement entered into with WPG;
>
> ii. WPG exited from MBIL on 16.3.2012 upon termination of Shareholder s Agreement and accordingly, the petitioner, on 30.4.2012, resigned as the Executive Director and as full time Director on 16.11.2012. The Form-32 to this effect was filed with the RoC;

iii. Under the loan sanction letters dated 12.12.2006, loan undertaking dated 2.3.2007 and another loan sanction letter dated 24.4.2010, MBIL was required to submit its quarterly statements and audited balance sheets to the respondent- Bank. The same duly reflected the investments made by MBIL in its subsidiaries;

iv. During the meeting of the lender banks on 20.7.2012, MBIL had categorically informed the banks that there were constraints in realizing the investments made in its subsidiaries due to financial stress. Thus, even prior to the finalisation of the CDR Scheme and resignation of petitioner from MBIL, the lender banks had complete knowledge of the investments in the subsidiaries;

v. The investment in the subsidiaries was made from the internal accruals and cash surpluses of MBIL and not from borrowed funds from lender banks. The cash accruals of MBIL from 2004-2011 was to the tune of Rs.2715 Crores. The investment in the subsidiaries was made from such internal accruals. The Master Circular can be invoked only in relation to borrowed funds. Since the investments were made from cash surpluses of MBIL, the proceeding under the Master Circular is without jurisdiction ;

vi. As MBIL faced financial constraints, the lender banks considered the proposal of MBIL for restructuring of debt under the CDR Scheme. The lender banks, including the respondent-Bank, directed MBIL to submit a Flash Report placing on its restructuring proposal. The MBIL gave its Flash Report, in which it was clearly stated that one of the reasons of financial constraints was the inability to unlock the investments made in the subsidiaries. Thus, the lender Banks were fully aware of the investments;

vii. The CDR-EG placed MBIL in Class-B under the CDR Master Circular, which does not apply where there is diversion of funds;

viii. The CDR-EG obtained a TEV Report from Ernst & Young and a Stock Audit Report from RRCA, which are external independent entities. Based on the Flash Report, TEV Report and the Stock Audit Report, the lender banks issued the FRS. The FRS is an internal document of the lender banks. The respondent-Bank has admitted in these proceedings that the FRS is "Bank's own document" in its counter affidavit filed in the present Writ Petition.

ix. In the FRS, the lender banks have themselves acknowledged, based on audited financial statements submitted by MBIL, that the investment in the subsidiaries of MBIL had taken place from the internal accruals of MBIL and not from the funds borrowed from the banks. It was contended that the Master Circular is triggered only when there is diversion or siphoning of borrowed funds and not otherwise. Further, in the FRS, the lender banks noted that there was no adverse movement of funds. In fact, one of the reasons for poor financial performance of MBIL was the inability to lock the investments made in the subsidiaries. Thus, from the very inception, the lender banks were fully aware that investments were made in the subsidiaries and the same was made from internal accruals and not from borrowed funds. The lender banks never categorised the investments as diversion of any borrowed loan amount;

x. Under the CDR Scheme, in particular Clause 6.3 read with 7.1 read with para 2 of Annexure III, while discharging public function and dealing with public funds, the banks acting through the CDR-EG, were required to ascertain whether there existed any instances of fraud or malfeasance or wilful default qua the affairs of MBIL. It was incumbent upon the banks/ CDR-EG to ensure that corporates engaging in fraud/malfeasance were not allowed, in public interest, to misuse the CDR scheme as that would amount to perpetrating the fraud already committed by a wilful defaulter borrower. If any such instances were found, the banks could and should have refused to either accept/ admit MBIL for CDR completely as per Clause 6.3 or imposed such onerous conditions upon MBIL as provided for in para C and D of Annexure IV of the CDR Scheme. In fact, under Clause 3.3 of the CDR Scheme itself, the banks, including the respondent-Bank, had the express option and power to conduct a forensic audit on their own before CDR approval. No such forensic audit was initiated or recommended or even considered necessary by the banks, including the respondent-Bank;

xi. It is contended that prior to the issuance of the FRS, the CDR-EG was in fact willing to classify MBIL in Class-A (i.e., "Corporate affected by external factors pertaining to economy and Industry"), which is the highest category, provided that MBIL gave a personal guarantee of the petitioner. However, because MBIL could not comply with this condition, it was allowed to retain Class-B. The offer to classify MBIL in Class-A and the eventual decision to retain Class-B, clearly establishes that, as required under the CDR Scheme, the banks including respondent-Bank did not find it necessary to conduct an investigation and analysis into the affairs of MBIL prior to admitting MBIL for a CDR package;

xii. Having (i) categorized MBIL as Class-B borrower at the stage of receipt of Flash Report, (ii) confirmed Class-B category for MBIL in the FRS after TEV Report and Stock Audit, (iii) finally admitted MBIL for CDR, (iv) felt no need for a forensic audit either before or during CDR and not even after the CDR failed, makes it clear that the banks did not find any event of fraud or malfeasance or diversion of funds. Otherwise, lender banks would not have admitted MBIL to CDR or have directed a forensic audit, at least, after they exited the CDR. The lender banks are, thus, estopped from contending that they did not have any opportunity to look at events of wilful default prior to the issuance of Forensic Audit Report;

xiii. On similar set of allegations against the petitioner, PNB and SBBJ issued show cause notice to the petitioner. After considering the explanation of the petitioner, both these banks dropped the wilful default proceedings against the petitioner;

xiv. The respondent-Bank has issued show cause notice to the petitioner eight years after he ceased to be the Director of MBIL and more than ten years since the investments were made by MBIL in its subsidiaries;

xv. The respondent-Bank, out of the six allegations of wilful default, exonerated the petitioner in respect of five allegations from no.2 to 6. However, in respect of allegation no.1, the respondent-Bank wrongly attributed the writing off of Rs.287.04 Crores from 1.4.2013 to 31.3.2015 to the petitioner as he ceased to be a Director of MBIL from 16.11.2012. No act of wilful default can

be attributed to the petitioner when he was not the Director of MBIL and ceased to have any role in MBIL;

xvi. In response to the show cause notice, the petitioner specifically stated in his reply that the investments in the subsidiaries were made from the internal accruals of MBIL and not from borrowed funds. Neither the Identification Committee nor the Review Committee ever adverted to the said defence in their respective orders. The orders passed by the Identification Committee and the Review Committee suffers from non-application of mind;

xvii. The Forensic Audit Report does not disclose any event of wilful default by the petitioner;

xviii. The impugned order passed by the Review Committee is, therefore, illegal, deserving to be set aside by this Court;

xix. Reliance is placed on the decisions in CAG v. K.S. Jagannathan1, SBI v. Jah Developers (P) Ltd.2, Chordia Automobiles v. S. Moosa3, Ram Kishan v. Tarun Bajaj4, Mohd. Mustafa v. Union of India5, Mekaster Trading Corporation v. Union of India6, Comptroller and Auditor General of India, Gian Prakash v. K.S. Jaganathan7, Achutananda Baidya v. Praffulya Kumar Gayen & Others8, State of Punjab v. Bandeep Singh9, Mohinder 1986 2 SCC 679 (2019) 6 SCC 787 (2000) 3 SCC 282 (2014) 16 SCC 204 (2022) 1 SCC 294 2003 SCC OnLine Del 794 (1986) 2 SCC 679 (1997) 5 SCC 76 (2016) 1 SCC 724 Singh Gill v. Chief Election Commissioner10, ABL International Ltd. v. Export Credit Guarantee Corpn. of India Ltd.11, NTPC Ltd. v. Mahesh Dutta12, Popatrao Vyankatrao Patil v. State of Maharashtra13, Real Estate Agencies v. State of Goa14, M.P. Power Management Co. Ltd. v. Sky Power Southeast Solar India (P) Ltd.15, Dewan & Sons Investment Pvt. Ltd. v. NDMC16, Radha Raman Samanta v. Bank of India17, Babu Verghese & Ors. v. Bar Counsel of Kerela18, Heinz India (P) Ltd. v. State of U.P.19, M. Siddiq (Ram Janmabhumi Temple- 5J.) v. Suresh Das20, NG Dastane v. S Dastane21, State of UP v. Sheo Shanker Lal Srivastava22, All India Railway Recruitment Board v. K Shyam Kumar23, Aap Infrastructure Ltd. v. Bank of Baroda24, Canara Bank v. P.R.N. Upadhyaya & Ors.25, SBI v. Rajesh Agarwal26, Erusian Equipment & Chemicals Ltd v. State of West (1978) 1 SCC 405 (2004) 3 SCC 553 (2009) 8 SCC 339 (2020) 19 SCC 241 (2012) 12 SCC 170 (2023) 2 SCC 703 1996 SCC OnLine Del 781 (2004) 1 SCC 605 (1999) 3 SCC 422 (2012) 5 SCC 443 (2020) 1 SCC 1 (1975) 2 SCC 326 (2006) 3 SCC 276 (2010) 6 SCC 614 2019 SCC OnLine Del 9670 (1998) 6 SCC 526 (2023) 6 SCC 1 Bengal27, Delhi Public School v. Central Board of Secondary Education28, Prashant Bothra v. Bureau of Immigrations & Ors.29 and Gorkha Securities v. Govt. of NCT of Delhi & Ors.30

47. Mr. Chinmoy Pradip Sharma, learned senior counsel appearing on behalf of the respondent-Bank, alongwith Mr. Kush Sharma, Standing Counsel and Mr. Nishchaya Nigam, Advocate, on the other hand, made the following submissions:

> i. The Review Committee has passed the impugned order after considering each and every point raised by the petitioner in his replies to the show cause notice;

ii. The Review Committee exonerated the petitioner from allegation nos.2 to 6, which shows application of mind;

iii. The respondent-Bank has complied with the procedure in the Master Circular and also the procedure laid down by the Hon ble Supreme Court in Jah Developers (supra), while declaring the petitioner as wilful defaulter;

(1975) 1 SCC 70 2020 SCC OnLine Guj 386 2023 SCC OnLine Cal 2643 (2014) 9 SCC 105 iv. The petitioner deliberately resigned in 2012 to escape his liabilities from the wrongdoings in MBIL. He resigned after the account turned NPA;

v. The MBIL had made investments in its subsidiaries when the petitioner was a whole time Director of MBIL. This fact has been mentioned in the Forensic Audit Report and hence, the respondent-Bank has rightly declared the petitioner as a wilful defaulter;

vi. There is no limitation in the Master Circular for issuance of show cause notice. As soon as the respondent-Bank became aware of the acts of wilful default from the contents of the Forensic Audit Report dated 3.6.2019, the respondent-Bank immediately took action;

vii. The validity of Master Circular is not under challenge by the petitioner;

viii. The Review Committee has passed well-reasoned order, which is based on the Forensic Audit Report and which had found diversion of funds. The Forensic Audit Report has not been challenged. This Court cannot sit in judgment over the Forensic Audit Report, which is prepared by an independent third party. The said Review Committee order does not warrant any interference from this Court;

ix. During the CDR process, no forensic audit was conducted and hence, the petitioner cannot take advantage of the fact that in the CDR process, MBIL was placed in Class-B as per CDR Master Circular;

x. The scope of judicial review over the order passed by the Review Committee is limited;

xi. Learned counsel placed reliance on the decisions in the cases of Sarvepalli Ramaih v. District Collector, Chittoor & Ors.31, State of UP v. Sheo Shanker Lal Srivastava & Ors.32, V. Ramana v. Andhra Pradesh State Transport Corporation Vishakapatnam & Ors.33, Nitin & Ors. v. IDBI Bank Limited & Ors.34, Rajesh Agarwal (supra) and LPA No. 597/2022 of this Court in the case of Kirtilal Ravchandbhai Sanghavi v. Reserve Bank of India & Anr.

ANALYSIS Scheme of RBI's Master Circular for declaring a person as "wilful defaulter"

48. Before going into the facts of the case, it is essential to examine the scheme of the Master Circular. In order to put in place a system to disseminate credit information pertaining to wilful defaulters for (2019) 4 SCC 500 (2006) 3 SCC 276 2001 SCC Online AP 705 cautioning banks and

financial institutions so as to ensure that further bank finance is not made available to them, the RBI, in exercise of power under Sections 21 and 35A of the Banking Regulation Act, 1949 issued the Master Circular dated 1.7.2015.

49. Originally, a scheme for declaration as wilful defaulter was framed by the RBI in 1999 on the recommendations made by the Central Vigilance Commission, which was subsequently modified in 2002. At the time of consideration of the petitioner s case, the Master Circular of 2015 was in force.

50. Clause 2.1.3 of the said Master Circular defines the event of "wilful default". In the present case, the petitioner has been declared a wilful defaulter under Clauses 2.1.3(b) and (c). Clause 2.1.3(b) provides that an event of wilful default shall be deemed to be occurred if the unit has defaulted in loan repayment obligation; has not utilized the loan amount for the purpose it was granted and diverted the funds for other purposes. Clause 2.1.3(c) provides that an event of wilful default shall be deemed to be occurred if the unit has defaulted in meeting loan repayment obligations; has siphoned off the funds and the funds are not utilized for the specific purpose for which the loan was availed.

51. The last part of Clause 2.1.3 also mandates that the identification of wilful default should be made keeping in view of track record of the borrower and not on the basis of isolated transactions/ incidents. It 2019 SCC Online Bom 1422 specifically mandates that a "default" in order to be categorized as "wilful" must be "intentional, deliberate and calculated". Clause 2.1.3(b) and (c), which have been invoked in the present case, reads as under:

> □2.1.3 Wilful Default: A 'wilful default' would be deemed to have occurred if any of the following events is noted:
>
> (a) The unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to honour the said obligations.
>
> (b) The unit has defaulted in meeting its payment / repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.
>
> (c) The unit has defaulted in meeting its payment / repayment obligations to the. lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.
>
> (d) The unit has defaulted in meeting its payment / repayment obligations to the lender and has also disposed off or removed the movable fixed assets or immovable property given for the purpose of securing a term loan without the knowledge of the bank /lender.

The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions/incidents. The default to be categorised as wilful must be intentional, deliberate and calculated.

52. A bare reading of Clauses 2.1.3(b) and (c) clearly reveals that an event of wilful default can only take place when the "loan amount" lent by the bank is diverted or siphoned off by the borrower, for any use, other than for which the loan was granted.

53. Clause 2.2 of the Master Circular defines "diversion of funds" and "siphoning of funds" as under:

> "2.2 Diversion and siphoning of funds: The terms □diversion of funds and □siphoning of funds should construe to mean the following: -
>
> 2.2.1 Diversion of funds, referred to at para 2.1(b) above, would be construed to include any one of the undernoted occurrences:
>
> (a) utilisation of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;
>
> (b) deploying borrowed funds for purposes / activities or creation of assets other than those for which the loan was sanctioned;
>
> (c) transferring borrowed funds to the subsidiaries / Group companies or other corporates by whatever modalities;
>
> (d) routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;
>
> (e) investment in other companies by way of acquiring equities / debt instruments without approval of lenders;
>
> (f) shortfall in deployment of funds vis-à-vis the amounts disbursed / drawn and the difference not being accounted for.

2.2.2 Siphoning of funds, referred to at para 2.1(c) above, should be construed to occur if any funds borrowed from banks / FIs are utilised for purposes un-related to the operations of the borrower, to the detriment of the financial health of the entity or of the lender. The decision as to whether a particular instance amounts to siphoning of funds would have to be a judgement of the lenders based on objective facts and circumstances of the case."

54. The definition of "diversion of funds" and "siphoning of funds", as aforesaid, also makes it explicitly clear that the event of "diversion of funds" or "siphoning of funds" can take place only when the "borrowed funds" are deployed or used, for any purpose, other than for which the loan was sanctioned. The Master Circular further places an obligation on the bank to make the judgment

about "diversion of funds" or "siphoning of funds" based on "objective facts and circumstances of the case."

55. Clause 2.5 of the Master Circular provides for initiation of penal measures against the persons or entities declared as wilful defaulter under Clause 2.1.3 of the Master Circular, which includes non-grant of additional loan facility by any bank or financial institution in the future; debarring them from floating new venture for a period of five years from the date of removal of name as wilful defaulter; initiation of criminal proceedings; change of management of borrower unit; non-induction of the person in the Board of the company etc. The last part of Clause 2.5 places a specific obligation on the banks to put in place a transparent mechanism so that the penal provisions of the said clause are not misused and the scope of such discretionary exercise of power is kept to a bare minimum. Solitary or isolated incidents are not to be used for the use of penal action under the said clause. Clause 2.5 reads as under:

> "2.5 Penal measures In order to prevent the access to the capital markets by the wilful defaulters, a copy of the list of wilful defaulters (non-suit filed accounts) and list of wilful defaulters (suit filed accounts) are forwarded to SEBI by RBI and Credit Information Bureau (India) Ltd. (CIBIL) respectively.
>
> The following measures should be initiated by the banks and FIs against the wilful defaulters identified as per the definition indicated at paragraph 2.1 above:
>
> a) No additional facilities should be granted by any bank / FI to the listed wilful defaulters. In addition, the entrepreneurs / promoters of companies where banks / FIs have identified siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from the scheduled commercial banks, Development Financial Institutions, Government owned NBFCs, investment institutions etc. for floating new ventures for a period of 5 years from the date the name of the wilful defaulter is published in the list of wilful defaulters by the RBI.
>
> b) The legal process, wherever warranted, against the borrowers / guarantors and foreclosure of recovery of dues should be initiated expeditiously. The lenders may initiate criminal proceedings against wilful defaulters, wherever necessary.
>
> c) Wherever possible, the banks and FIs should adopt a proactive approach for a change of management of the wilfully defaulting borrower unit.
>
> d) A covenant in the loan agreements with the companies in which the banks/FIs have significant stake, should be incorporated by the banks/FIs to the effect that the borrowing company should not induct on its board a person whose name appears in the list of Wilful Defaulters and that in case, such a person is found to be on its board, it would take expeditious and effective steps for removal of the person from its board. It would be imperative on the part of the banks and FIs to put in place a transparent

> mechanism for the entire process so that the penal provisions are not misused and the scope of such discretionary powers are kept to the barest minimum.

It should also be ensured that a solitary or isolated instance is not made the basis for imposing the penal action."

56. Clause 2.9 provides that the RBI under the "Credit Information Companies (Regulations) Act, 2015" has granted certificate to four Credit Information Companies. The lender banks should submit a list of wilful defaulters to such Credit Information Companies. This would make the list of wilful defaulters available to banks and financial institutions on real time basis and dissuade them from grant of credit facility to such persons and entities. Clause 2.9 reads as under:

> "2.9 Reporting to RBI / Credit Information Companies
>
> (a) Banks/FIs should submit the list of suit-filed accounts of wilful defaulters of Rs.25 lakh and above as at end-March, June, September and December every year to a credit information company which has obtained certificate of registration from RBI in terms of Section 5 of the Credit Information Companies (Regulation) Act, 2005 and of which it is a member. Reserve Bank of India has, in exercise of the powers conferred by the Act and the Rules and Regulations framed thereunder, granted Certificate of Registration to (i) Experian Credit Information Company of India Private Limited, (ii) Equifax Credit Information Services Private Limited, (iii) CRIF High Mark Credit Information Services Private Limited and (iv) Credit Information Bureau (India) Limited (CIBIL) to commence/carry on the business of credit information.

Credit Information Companies (CICs) have also been advised to disseminate the information pertaining to suit filed accounts of Wilful Defaulters on their respective websites.

(b) Banks / FIs should, however, submit the quarterly list of wilful defaulters where suits have not been filed only to RBI in the format given in Annex 1.

(c) In order to make the current system of banks/FIs reporting names of suit filed accounts and non-suit filed accounts of Wilful Defaulters and its availability to the banks by CICs / RBI as current as possible, banks / FIs are advised to forward data on wilful defaulters to the CICs/Reserve Bank at the earliest but not later than a month from the reporting date.

d) After examining the recommendations of the Committee to Recommend Data Format for Furnishing of Credit Information to Credit Information Companies (Chairman: Shri. Aditya Puri) it has been decided to implement the following measures with regard to reporting and dissemination of information on wilful defaulters:

> a. Banks/FIs may continue to furnish the data on wilful defaulters (non-suit filed accounts) of Rs. 25 lakhs and above for the quarter ending June 30, 2014 and

September 30, 2014 to RBI in the existing format.

b. In terms of Credit Information Companies (Regulation) Act, 2005, banks/FIs are advised to furnish the aforementioned data in respect of wilful defaulters (non-suit filed accounts) of Rs. 25 lakhs and above for the quarter ending December 31, 2014 to CICs and not to RBI. Thereafter, banks/FIs may continue to furnish data in respect of wilful defaulters to CICs on a monthly or a more frequent basis. This would enable such information to be available to the banks/FIs on a near real time basis. Explanation In this connection, it is clarified that banks need not report cases where

(i) outstanding amount falls below Rs.25 lakh and

(ii) in respect of cases where banks have agreed for a compromise settlement and the borrower has fully paid the compromised amount."

57. Clause 3 of the Master Circular provides the mechanism for identifying a wilful defaulter. The said provision provides that the evidence of wilful default shall be examined by a Committee headed by Executive Director or equivalent and consisting of two other senior officers of the rank of GM/DGM. If the said Committee concluded that an event of wilful default has occurred, it shall issue a show cause notice to the concerned unit or person calling for his response. After consideration of the response, a final order recording the event of wilful default, or otherwise, may be issued alongwith the reasons for the same. Wherever the Committee considers necessary, an opportunity of personal hearing should also be granted. This Committee is called as the "Identification Committee."

58. The order of the Identification Committee shall be reviewed by another Committee headed by the Chairman/MD/CEO and two other independent/non-Executive Directors of the bank. The order declaring a person as wilful defaulter shall become final only after it is confirmed by this Review Committee. The said clause also provides that under Section 2(60) of the Companies Act, 2013, an officer who is in "default" to mean only "whole time director" unless the case falls in the category of exceptions enumerated in the said clause. Clause 3 reads as under:

"3. Mechanism for identification of Wilful Defaulters The transparent mechanism referred to in paragraph 2.5(d) above should generally include the following:

(a) The evidence of wilful default on the part of the borrowing company and its promoter/whole-time director at the relevant time should be examined by a Committee headed by an Executive Director and consisting of two other senior officers of the rank of GM/DGM.

(b) If the Committee concludes that an event of wilful default has occurred, it shall issue a Show Cause Notice to the concerned borrower and the promoter/whole-time director and call for their submissions and after considering their submissions issue an order recording the fact of wilful default and the reasons for the same. An

opportunity should be given to the borrower and the promoter/whole-time director for a personal hearing if the Committee feels such an opportunity is necessary.

(c) The Order of the Committee should be reviewed by another Committee headed by the Chairman / CEO and MD and consisting, in addition, of two independent directors of the Bank and the Order shall become final only after it is confirmed by the said Review Committee.

(d) As regard a non-promoter/non-whole time director, it should be kept in mind that Section 2(60) of the Companies Act, 2013 defines an officer who is in default to mean only the following categories of directors:

(i) Whole-time director

(ii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;

(iii) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings and who has not objected to the same, or where such contravention had taken place with his consent or connivance.

Therefore, except in very rare cases, a non-whole-time director should not be considered as a wilful defaulter unless it is conclusively established that I. he was aware of the fact of wilful default by the borrower by virtue of any proceedings recorded in the Minutes of the Board or a Committee of the Board and has not recorded his objection to the same in the Minutes, or, II. the wilful default had taken place with his consent or connivance.

A similar process as detailed in sub paras (a) to (c) above should be followed when identifying a non-promoter/non-whole time director as a wilful defaulter.

59. Clause 4.2(iii) also provides for initiation of criminal proceedings against declared wilful defaulters, wherever necessary.

Consequences of a person or entity being declared as a wilful defaulter

60. As discussed earlier, the object of the Master Circular is salutary. The Master Circular aims to protect the country s banks and financial institutions from unscrupulous entities and individuals. It is intended to identify and punish those entities and individuals who have diverted or siphoned off borrowed funds for purposes other than for which the loan facility was availed leading to default in the repayment obligations. Such individuals and entities must be identified and their names be published in public domain so that they are barred from availing any further loan facility from any

other bank. If such an exercise is not undertaken, the cycle of diversion/siphoning of borrowed funds; default and re- borrowing, leading to same situation may continue. Such a scenario may adversely affect the liquidity of the banking system and affect the overall financial health of the country. There is, thus, no doubt that the Master Circular aims to achieve a very lauded object. Notably, the scheme of the Master Circular indicates that it is both a punitive and preventive measure.

61. However, it needs to be acknowledged that the consequences for an individual or an entity who is declared as wilful defaulter are also drastic. As discussed earlier, such an individual or entity is barred from availing any loan facility in the future; is proscribed from floating new venture; and may face criminal proceedings. Additionally, being labelled as wilful defaulter in public domain also affects the reputation of such individual and entity. Business entities would hesitate to do any business or dealing with someone who is declared as wilful defaulter. The availability of loans from financial institutions is the backbone of doing business. It is not only a mode of raising finance but it is also an indicator of the creditworthiness of the business entity. Hence, the deprivation to avail such facility virtually knocks a financial death knell on such individual or entity.

62. The Hon ble Supreme Court in the case of Jah Developers (supra), had an occasion to examine the consequences of a person being declared as wilful defaulter under the Master Circular. The Hon ble Supreme Court held that a person declared as wilful defaulter affects the fundamental right of a person under Article 19(1)(g) of the Constitution as it directly affects the right to do business and thus, the Master Circular must be construed reasonably. The relevant paragraph of the said decision reads as under:-

> "24. Given the above conspectus of case law, we are of the view that there is no right to be represented by a lawyer in the in-house proceedings contained in Para 3 of the Revised Circular dated 1-7- 2015, as it is clear that the events of wilful default as mentioned in Para 2.1.3 would only relate to the individual facts of each case. What has typically to be discovered is whether a unit has defaulted in making its payment obligations even when it has the capacity to honour the said obligations; or that it has borrowed funds which are diverted for other purposes, or siphoned off funds so that the funds have not been utilised for the specific purpose for which the finance was made available. Whether a default is intentional, deliberate, and calculated is again a question of fact which the lender may put to the borrower in a show-cause notice to elicit the borrower's submissions on the same. However, we are of the view that Article 19(1)(g) is attracted in the facts of the present case as the moment a person is declared to be a wilful defaulter, the impact on its fundamental right to carry on business is direct and immediate. This is for the reason that no additional facilities can be granted by any bank/financial institutions, and entrepreneurs/promoters would be barred from institutional finance for five years. Banks/financial institutions can even change the management of the wilful defaulter, and a promoter/director of a wilful defaulter cannot be made promoter or director of any other borrower company. Equally, under Section 29-A of the Insolvency and Bankruptcy Code, 2016, a wilful defaulter cannot even apply to be a resolution applicant. Given these drastic

consequences, it is clear that the Revised Circular, being in public interest, must be construed reasonably. This being so, and given the fact that Para 3 of the Master Circular dated 1-7-2013 permitted the borrower to make a representation within 15 days of the preliminary decision of the First Committee, we are of the view that first and foremost, the Committee comprising of the Executive Director and two other senior officials, being the First Committee, after following Para 3(b) of the Revised Circular dated 1-7-2015, must give its order to the borrower as soon as it is made. The borrower can then represent against such order within a period of 15 days to the Review Committee. Such written representation can be a full representation on facts and law (if any). The Review Committee must then pass a reasoned order on such representation which must then be served on the borrower. Given the fact that the earlier Master Circular dated 1-7-2013 itself considered such steps to be reasonable, we incorporate all these steps into the Revised Circular dated 1-7-2015."

63. Subsequently, in the case of Rajesh Agarwal (supra), the Hon ble Supreme Court dealt with another similar Circular issued by the RBI known as the Master Directions on Frauds. The said Circular deals with the mechanism to declare an account as fraud. The Hon ble Supreme Court held that such classifications entail serious civil consequences for the borrower. The proceedings forming an opinion about classification as fraud are "administrative" in nature and the principles of natural justice apply to the administrative decision making. It was held that there are both civil as well as penal consequences. Such consequences in the Master Directions on Frauds are similar to the consequences envisaged in the Master Circular and hence the observations made by the Hon ble Supreme Court in Jah Developers (supra) squarely applied. It was further held that the bar from raising finances could be fatal for the borrower leading to its "civil death" in addition to the infraction of their rights under Article 19(1)(g) of the Constitution. It was further held that classifying an account as fraud not only affects the business and goodwill of the borrower, but also the right to reputation. The relevant observations are as under:

"2. In this background the Court has to consider whether the principles of natural justice should be read into the provisions of the Master Directions on Frauds. For the reasons to follow, we hold that the principles of natural justice, particularly the rule of audi alteram partem, has to be necessarily read into the Master Directions on Frauds to save it from the vice of arbitrariness. Since the classification of an account as fraud entails serious civil consequences for the borrower, the directions must be construed reasonably by reading into them the requirement of observing the principles of natural justice.

***

40. The process of forming an informed opinion under the Master Directions on Frauds is administrative in nature. This has also been acceded to by RBI and lender banks in their written submissions. It is now a settled principle of law that the rule of audi alteram partem applies to administrative actions, apart from judicial and quasi-judicial functions. It is also a settled position in administrative law that it is

mandatory to provide for an opportunity of being heard when an administrative action results in civil consequences to a person or entity.

***

46. There is a consistent pattern of judicial thought that civil consequences entail infractions not merely of property or personal rights, but also of civil liberties, material deprivations, and non- pecuniary damages. Every order or proceeding which involves civil consequences or adversely affects a citizen should be in accordance with the principles of natural justice.

47. The next question that requires our consideration is whether the classification of a borrower's account as fraudulent under the Master Directions on Frauds entails civil consequences to the borrowers.

*** 50.3. The above consequences show that the classification of a borrower's account as fraud under the Master Directions on Frauds has difficult civil consequences for the borrower. The classification of an account as fraud not only results in reporting the fact to investigating agencies, but has other penal and civil consequences as specified in Clauses 8.12.1 and 8.12.3.

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53. Since the consequences flowing from the two circulars are similar, the observations in Jah Developers on the effect of declaring a borrower as wilful defaulter will be squarely applicable to the present case.

***

55. Classification of the borrower's account as fraud under the Master Directions on Frauds virtually leads to a credit freeze for the borrower, who is debarred from raising finance from financial markets and capital markets. The bar from raising finances could be fatal for the borrower leading to its □civil death in addition to the infraction of their rights under Article 19(1)(g) of the Constitution. Since debarring disentitles a person or entity from exercising their rights and/or privileges, it is elementary that the principles of natural justice should be made applicable and the person against whom an action of debarment is sought should be given an opportunity of being heard.

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57. A blacklist is : (i) a list of insolvent or untrustworthy persons published by a commercial agency or mercantile association; and

(ii) a list of persons unworthy of credit, or with whom it is not advisable to make contracts. Before this Court, RBI and lender banks have submitted that debarring borrowers from accessing institutional finance is necessary to not only prevent the same persons from committing frauds in other banks, but also to proscribe banks from dealing with unscrupulous borrowers in public interest. Debarring a borrower under Clause 8.12.1 of the Master Directions on Frauds is akin to blacklisting the borrower for being untrustworthy and unworthy of credit by the banks. This Court has consistently held that an opportunity of a hearing ought to be provided before a person is put on a blacklist.

***

62. Classification of a borrower's account as fraud has the effect of preventing the borrower from accessing institutional finance for the purpose of business. It also entails significant civil consequences as it jeopardises the future of the business of the borrower. Therefore, the principles of natural justice necessitate giving an opportunity of a hearing before debarring the borrower from accessing institutional finance under Clause 8.12.1 of the Master Directions on Frauds. The action of classifying an account as fraud not only affects the business and goodwill of the borrower, but also the right to reputation.

***

63. In State of Maharashtra v. Public Concern for Governance Trust, a two-Judge Bench of this Court held that a decision taken by any authority affecting the right to reputation of an individual has civil consequences. Therefore, in such situations the principles of natural justice would come into play. The Court held that any order or decision of the authority adversely affecting the personal reputation of an individual must be taken after following the principles of natural justice : (SCC p. 606, para 41) □41. It is thus amply clear that one is entitled to have and preserve one's reputation and one also has a right to protect it. In case any authority in discharge of its duties fastened upon it under the law, travels into the realm of personal reputation adversely affecting him, it must provide a chance to him to have his say in the matter. In such circumstances, right of an individual to have the safeguard of the principles of natural justice before being adversely commented upon is statutorily recognised and violation of the same will have to bear the scrutiny of judicial review.

64. RBI and lender banks have relied on Peerless General Finance & Investment Co. Ltd. v. RBI, Joseph Kuruvilla Vellukunnel v. RBI and Internet & Mobile Assn. of India v. RBI to submit that the Master Directions on Frauds are akin to a statutory regulation and a decision on economic policy, which must be accorded a level of deference.

65. The competence of RBI to issue the Master Directions on Frauds is not a bone of contention in these appeals. RBI, in its estimation, has the power to determine and frame economic measures in the public interest to ensure the proper management of banking companies. The point however is that the implementation of a decision to secure the health of banking companies must comport with the due process of law. The civil consequences which follow upon a classification of a borrower's

account as fraud are serious and prejudicial to the interests of a borrower. Principles of fair play require that the borrower ought to be given an opportunity of being heard before classifying the account as fraud in accordance with the procedure laid down under the Master Directions on Frauds.

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94. Before concluding, we also want to address the argument by the borrowers that the requirement of passing a reasoned order must be read into the Master Directions on Frauds. The borrowers also relied on Jah Developers wherein it was held that a final decision of the Review Committee declaring the borrower as a □wilful defaulter must be made by a reasoned order. We agree with this contention of the borrowers because : (i) a reasoned order allows an aggrieved party to demonstrate that the reasons which persuaded the authority to pass an adverse order against the interests of the aggrieved party are extraneous or perverse; and (ii) the obligation to record reasons acts as a check on the arbitrary exercise of the powers. The reasons to be recorded need not be placed on the same pedestal as a judgment of a court. The reasons may be brief but they must comport with fairness by indicating a due application of mind."

64. As held by the Hon ble Supreme Court, the declaration of a person as wilful defaulter and barring him from credit facility in the future have civil and penal consequences, which also have the effect of adversely affecting his reputation. Thus, the declaration of a person as wilful defaulter, apart from adversely affecting the fundamental rights guaranteed under Article 19(1)(g) of the Constitution, also affects the right to reputation of a person, which is also a fundamental right guaranteed under Article 21 of the Constitution. The decisions of the Hon ble Supreme Court in the cases of Sukhwant Singh v. State of Punjab35, Subramanian Swamy v. Union of India36 and Om Prakash Chautala v. Kanwar Bhan37 are noteworthy in this regard.

> "Standard of proof" to decide the validity of event of wilful default under Master Circular (2009) 7 SCC 559 (2016) 7 SCC 221 (2014) 5 SCC 417

65. As discussed above, since the declaration of a person as wilful defaulter has both civil and penal consequences; it affects the fundamental right to do business under Article 19(1)(g) and affects the right to reputation under Article 21 of the Constitution, the next question that follows is what should be the standard of proof to decide the validity of an event of wilful default under the Master Circular.

66. The proceedings under the Master Circular are civil in nature. Ordinarily, the validity of a civil action is decided on a preponderance of probability. However, it has been laid down by the Hon ble Supreme Court in the case of Heinz India (P) Ltd. (supra) that the nature of proof within this test varies and depends upon the subject matter. The graver the charge and consequences, the higher the degree of proof required:

> "43. In England, the civil standard of proof is defined by Lord Denning in Miller v. Minister of Pensions thus: (All ER p. 373 H) □(1) ... It need not reach certainty, but it must carry a high degree of probability. Proof beyond reasonable doubt does not

mean proof beyond the shadow of doubt. The law would fail to protect the community if it admitted fanciful possibilities to deflect the course of justice. If the evidence is so strong against a man as to leave only a remote possibility in his favour which can be dismissed with the sentence ☐of course it is possible, but not in the least probable,' the case is proved beyond reasonable doubt, but nothing short of that will suffice.

44. Three years later came Bater v. Bater in which the civil standard of proof was to an extent modified, was seen by some jurists as somewhat confusing the concept so clearly stated in Miller case. In Bater the Court declared that neither civil nor criminal standard of proof was an absolute standard. A ☐civil case may be proved by a preponderance of probability, explained Denning, J.: (Bater case, All ER p. 459) ☐.. but there may be degrees of probability within that standard. The degree depends on the subject-matter. A civil court, when considering a charge of fraud, will naturally require a higher degree of probability than that which it would require if considering whether negligence were established. It does not adopt so high a degree as a criminal court, even when it is considering a charge of a criminal nature, but still it does require a degree of probability which is commensurate with the occasion.

45. Then came Hornal v. Neuberger Products Ltd. where the Court held that: (QB p. 247) ☐In a civil action where fraud or other matter which is or may be a crime is alleged against a party or against persons not parties to the action, the standard of proof to be applied is that applicable in civil actions generally, namely, proof on the balance of probability, and not the higher standard of proof beyond all reasonable doubt required in criminal matters; but there is no absolute standard of proof, and no great gulf between proof in criminal and civil matters; for in all cases the degree of probability must be commensurate with the occasion and proportionate to the subject-matter. The elements of gravity of an issue are part of the range of circumstances which have to be weighed when deciding as to the balance of probabilities.

46. The law in England, therefore, is that degree of probability must be commensurate with the subject-matter. This implies that graver the charge in a civil action, higher the degree of proof required. A civil case may be proved by preponderance of probability, but the degree of probability would depend upon the nature of the subject-matter."

67. Subsequently, in the case of M. Siddiq (Ram Janmabhumi Temple-5 J.) (supra), the Constitution Bench of the Hon ble Supreme Court reiterated that in standard of preponderance of probabilities, there could be different degrees of probability and the degree depends upon the subject matter. The civil action which affects the status of parties requires a closer scrutiny. The relevant observations are as under:

"The standard of proof

720. The court in a civil trial applies a standard of proof governed by a preponderance of probabilities. This standard is also described sometimes as a balance of probability or the preponderance of the evidence. Phipson on Evidence formulates the standard succinctly : If therefore, the evidence is such that the court can say □we think it more probable than not , the burden is discharged, but if the probabilities are equal, it is not. In Miller v. Minister of Pensions, Lord Denning, J. (as the Master of Rolls then was) defined the doctrine of the balance or preponderance of probabilities in the following terms : (All ER p. 373 H) □(1) ... It need not reach certainty, but it must carry a high degree of probability. Proof beyond reasonable doubt does not mean proof beyond the shadow of doubt. The law would fail to protect the community if it admitted fanciful possibilities to deflect the course of justice. If the evidence is so strong against a man as to leave only a remote possibility in his favour which can be dismissed with the sentence, □of course it is possible, but not in the least probable the case is proved beyond reasonable doubt, but nothing short of that will suffice. (emphasis supplied)

721. The law recognises that within the standard of preponderance of probabilities, there could be different degrees of probability.

This was succinctly summarised by Denning, L.J. in Bater v. Bater, where he formulated the principle thus : (p. 37) □.. So also in civil cases, the case must be proved by a preponderance of probability, but there may be degrees of probability within that standard. The degree depends on the subject-matter. (emphasis supplied)

722. The definition of the expression □proved in Section 3 of the Evidence Act is in the following terms:

□3. ... "Proved".--A fact is said to be proved when, after considering the matters before it, the court either believes it to exist, or considers its existence so probable that a prudent man ought, under the circumstances of the particular case, to act upon the supposition that it exists.

723. Proof of a fact depends upon the probability of its existence. The finding of the court must be based on:

723.1. The test of a prudent person, who acts under the supposition that a fact exists.

723.2. In the context and circumstances of a particular case.

724. Analysing this, Y.V. Chandrachud, J. (as the learned Chief Justice then was) in N.G. Dastane v. S. Dastane held : (SCC pp.

335-36, para 24) □The belief regarding the existence of a fact may thus be founded on a balance of probabilities. A prudent man faced with conflicting probabilities concerning a fact situation will act

on the supposition that the fact exists, if on weighing the various probabilities he finds that the preponderance is in favour of the existence of the particular fact. As a prudent man, so the court applies this test for finding whether a fact in issue can be said to be proved. The first step in this process is to fix the probabilities, the second to weigh them, though the two may often intermingle. The impossible is weeded out at the first stage, the improbable at the second. Within the wide range of probabilities the court has often a difficult choice to make but it is this choice which ultimately determines where the preponderance of probabilities lies. Important issues like those which affect the status of parties demand a closer scrutiny than those like the loan on a promissory note: □the nature and gravity of an issue necessarily determines the manner of attaining reasonable satisfaction of the truth of the issue, CLR at p. 210'; or as said by Lord Denning, □the degree of probability depends on the subject-matter'. In proportion as the offence is grave, so ought the proof to be clear, All ER at p. 536'. But whether the issue is one of cruelty or of a loan on a pronote, the test to apply is whether on a preponderance of probabilities the relevant fact is proved. In civil cases this, normally, is the standard of proof to apply for finding whether the burden of proof is discharged. (emphasis supplied)

725. The Court recognised that within the standard of preponderance of probabilities, the degree of probability is based on the subject-matter involved."

68. It is also a settled principle of law that action, which has penal consequences, must be strictly construed. For reference, the decisions of the Hon ble Supreme Court in the case of Supreme Court Bar Assn. v. Union of India38, Manohar v. State of Maharashtra39, State of U.P. v. Lalai Singh Yadav40, Regl. Provident Fund Commr. v. Hooghly Mills Co. Ltd.41 and Glaxo Laboratories (I) Ltd. v. Presiding Officer42 are noteworthy in this regard.

69. From the aforesaid enunciation of law, it is evident that in the test of validity of civil action on preponderance of probability, the graver the consequences of such civil action, the higher is the degree of proof required. The court must first consider the existing probabilities, followed by a comparative analysis of the respective weights to be attached to the probabilities. The degree of probability is based on the subject matter. The subject matter under scrutiny is one of the circumstances to be kept in mind while deciding the degree of proof. While accepting the probability in favour of one fact over the other, the court must be in a position to say that a reasonable person could proceed (1998) 4 SCC 409 (2012) 13 SCC 14 (1976) 4 SCC 213 (2012) 2 SCC 489 with a supposition that such fact exists. This test is not only in conformity with the precedents discussed above but is also in tandem with Section 3 of the Indian Evidence Act, 1872. If this principle of law is tested on the anvil of the Master Circular, it is clear that the Master Circular entails not only grave civil, but also penal consequences. Considering the subject matter and grave civil and penal consequences, the validity of an order declaring as wilful defaulter would require a closer scrutiny as to whether such an order falls within the four corners of the Master Circular or is it otherwise.

Scope of judicial review in administrative action

70. Before this Court delves deeper into the facts of the present case, it is also important to discuss the scope of judicial review in administrative action. The Hon ble Supreme Court in the case of

Rajesh Agarwal (supra) has held that the act of declaring a person as wilful defaulter or fraud is in the nature of administrative action. The scope of judicial review on administrative action is well defined. It is not necessary to discuss judicial decisions in detail except to note a recent decision of the Hon ble Supreme Court in Mohd. Mustafa (supra), wherein, it was reiterated that if the discretionary power has been exercised in disregard of relevant consideration, the Court would hold the action bad in law. If the relevant, germane and valid considerations are ignored or overlooked by an executive authority while taking a decision, the same would fail to (1984) 1 SCC 1 withstand judicial scrutiny. The relevant observations are reproduceas under:

> "15. Judicial review may be defined as a Court's power to review the actions of other branches or levels of Government; especially the Court's power to invalidate legislative and executive actions as being unconstitutional. Power of judicial review is within the domain of the judiciary to determine the legality of administrative action and the validity of legislations and it aims to protect citizens from abuse and misuse of power by any branch of the State. The power of judicial review is a basic feature of the Constitution of India. Judicial review has certain inherent limitations. However, it is suited more for adjudication of disputes other than for performing administrative functions. It is for the executive to administer law and the function of the judiciary is to ensure that the Government carries out its duties in accordance with the provisions of the Constitution.
>
> 16. The grounds on which administrative action is subject to judicial review are illegality, irrationality and procedural impropriety. The following observations made by Lord Diplock in Council of Civil Service Unions v. Minister for Civil Service are apt : (AC pp. 410-11) □By □llegality as a ground for judicial review I mean that the decision-maker must understand correctly the law that regulates his decision-making power and must give effect to it. Whether he has or not is par excellence a justiciable question to be decided, in the event of dispute, by those persons, the Judges, by whom the judicial power of the State is exercisable. By □rrationality I mean what can by now be succinctly referred to as □Wednesbury unreasonableness . It applies to a decision which is so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it. Whether a decision falls within this category is a question that Judges by their training and experience should be well equipped to answer, or else there would be something badly wrong with our judicial system. To justify the court's exercise of this role, resort I think is today no longer needed to Viscount Radcliffe's ingenious explanation in Edwards v. Bairstow, of irrationality as a ground for a court's reversal of a decision by ascribing it to an inferred though unidentifiable mistake of law by the decision-maker. □rrationality by now can stand on its own feet as an accepted ground on which a decision may be attacked by judicial review.
>
> I have described the third head as □procedural impropriety rather than failure to observe basic rules of natural justice or failure to act with procedural fairness towards

the person who will be affected by the decision. This is because susceptibility to judicial review under this head covers also failure by an Administrative Tribunal to observe procedural rules that are expressly laid down in the legislative instrument by which its jurisdiction is conferred, even where such failure does not involve any denial of natural justice. But the instant case is not concerned with the proceedings of an Administrative Tribunal at all.

17. The discretionary power vested in an administrative authority is not absolute and unfettered. In Wednesbury, Lord Greene was of the opinion that discretion must be exercised reasonably. Explaining the concept of unreasonableness, Lord Greene stated that a person entrusted with discretion must direct himself properly in law and that he must call his own attention to the matter which he is bound to consider. He observed that the authority must exclude from his consideration matters which are irrelevant to the matter he is to consider. Lord Greene concluded that if an authority does not obey aforementioned rules, he may truly be said, and often is said, to be acting unreasonably.

18. Conditions prompted by extraneous or irrelevant considerations are unreasonable and liable to be set aside by Courts in exercise of its power under judicial review. (See State of U.P. v. Raja Ram Jaiswal, Sheonandan Paswan v. State of Bihar, Sant Raj v. O.P. Singla, Padfield v. Minister of Agriculture, Fisheries & Food.) A decision can be arrived at by an authority after considering all relevant factors. If the discretionary power has been exercised in disregard of relevant consideration, the Court will normally hold the action bad in law. Relevant, germane and valid considerations cannot be ignored or overlooked by an executive authority while taking a decision. It is trite law that Courts in exercise of power under judicial review do not interfere with selections made by expert bodies by reassessing comparative merits of the candidates. Interference with selections is restricted to decisions vitiated by bias, mala fides and contrary to statutory provisions. (See Dalpat Abasaheb Solunke v. B.S. Mahajan, Badrinath v. State of T.N., National Institute of Mental Health & Neuro Sciences v. K. Kalyana Raman, I.P.S. Dewan v. Union of India, UPSC v. Hiranyalal Dev, M.V. Thimmaiah v. UPSC and UPSC v. M. Sathiya Priya.)"

Scheme of Corporate Debt Restructuring ("CDR") issued by the RBI

71. The RBI has framed the CDR Master Circular enabling the lender banks to prepare a CDR scheme in respect of a business entity, which is struggling in meeting its existing loan repayment obligations. The CDR Master Circular requires the borrower to submit a Flash Report to the lender banks making the restructuring proposal. Wherever necessary, the lender banks would obtain a TEV Report to ascertain the viability of the company. The CDR Master Circular also requires the lender banks to change the management of the company where there has been "diversion of funds". In case of "diversion of funds", wherever necessary, the banks may also carry out forensic audit of the company. Clause 3 of the CDR Master Circular reads as under: -

"3. SCRUTINY BEFORE CDR REFERENCE/APPROVAL 3.1 Referring Institution (RI) should ensure primafacie viability of units at the time of submission of Flash Report. Wherever necessary TEV study from independent reputed agencies be conducted while drafting the final CDR package.

3.2 RI/MI may also examine the possibility of change of manageme nt while drafting the final CDR package. If the case has been found to be adversely affected due to incompetent management of the Company or where diversion/misuse of funds has taken place, change of management should be the first option.

3.3 Wherever necessary and specially in cases of diversion of funds, forensic audit/ special investigative audit may be got carried out by the MI."

72. Similarly, Clause 6.3 of the CDR Master Circular provides that companies indulging in frauds and malfeasance will remain ineligible for the CDR Scheme. Clause 6.3 reads as under: -

"6.3 Wilful Defaulters RBI in its guidelines on CDR mechanism has stipulated as under:

While corporate indulging in frauds and malfeasance even in a single bank will continue to remain ineligible for restructuring under CDR mechanism as hitherto, the Core group may review the reasons for classification of the borrower as wilful defaulter specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent and satisfy itself that the borrower is in a position to rectify the wilful default provided he is granted an opportunity under the CDR mechanism. Such exceptional cases maybe admitted for restructuring with the approval of the Core Group only. The Core Group may ensure that cases involving frauds or diversion of funds with mala fide intent are not covered. In view of the above, details of eligibility criteria to be followed in respect of cases of willful defaulters etc. are given in Annexure III.

73. Clause 6.3 specifically requires the Core Group of banks to "ensure that cases involving frauds or diversion of funds with mala fide intent are not covered." The said clause further provides that the □details of eligibility criteria to be followed in respect of cases of wilful defaulters etc. are given in Annexure III.

74. Annexure III, which relates to "Cases of Wilful Defaulters:

Eligibility Criteria, Financial Viability Parameters Procedural Aspects"

thereof makes reference to RBI s guidelines issued on 2.7.2012, which define "wilful default" as:

> (i) The unit has defaulted in meeting its payment/ repayment obligations to the lender even when it has the capacity to honour the said obligations.
>
> (ii) The unit has defaulted in meeting its payment/ repayment obligations to the lender and has not utilized the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.
>
> (iii) The unit has defaulted in meeting its payment/ repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilized for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.
>
> (iv) The unit has defaulted in meeting its payment/ repayment obligations to the lender and has also disposed off or removed the movable fixed assets or immovable property given by him or it for the purpose of securing a term loan without the knowledge of the bank/ lender.

75. The aforesaid definition of wilful default in RBI s guidelines issued on 2.7.2012 is identical to the definition of wilful default as defined in the Master Circular in question in the present case.

76. Paragraph 2 of Annexure III of the CDR Master Circular then mandates that "Banks/ FIs should take" specified "measures in identifying and reporting instances of wilful default". These steps are similar to the steps provided in the Master Circular viz. identification by Identification Committee, show cause notice to borrower, representation before Grievance Redressal Committee/ Review Committee and finally a decision.

77. Paragraph 4 restates that "Cases of Wilful Defaulter Not Eligible Under CDR". This clarifies again that cases of reported siphoning of funds or misfeasance, fraud etc. are prima facie not eligible to be covered under CDR.

78. Paragraph 5 mandates referring institution to check list of wilful defaulters as maintained by RBI/ CIBIL to verify whether any FI/ bank has reported the company as wilful defaulter and inter alia, report such instances to the CDR-EG.

79. Where a borrower is classified as a wilful defaulter, the core group may review the reasons for such classification and even such exceptional cases may be admitted for CDR, but they are required to undergo a much more onerous and rigorous process before an MRA/ TRA is executed.

80. Clause 7 of the CDR Master Circular enjoins the lender banks to classify the borrowing company in one of the four categories from A to D. Category-C is assigned where there is diversion of funds by the company:

> "7. BORROWER CLASSIFICATION FOR STIPULATION OF STANDARD TERMS AND CONDITIONS 7.1 It is observed that borrower -

> Corporate get into a stress situation because of various external and internal factors. The restructuring schemes are accordingly formulated envisaging various actions on the part of the borrowers and participating lenders. Based on experience and various features of the borrower-corporate and their promoters/sponsors, the borrower-corporate are categorized into four Classes for the purpose of stipulation of standard terms & conditions under the CDR Mechanism. The classification is as under:
>
> Borrower Class 'A':
>
> Corporate affected by external factors pertaining economy and Industry.
>
> Borrower Class 'B':
>
> Corporate/promoters affected by external factors and also having weak resources, inadequate vision, and not having support of professional management.
>
> Borrower Class 'C':
>
> Over-ambitious promoters; and borrower-corporate which diverted funds to related/unrelated fields with/without lenders' permission.
>
> Borrower Class 'D':
>
> Financially undisciplined borrower-corporate."

81. Clause 7.2 provides that:

> "The classification of each borrower-corporate shall be decided at the meeting of the CDR Empowered Group (EG) whereat the Financial Restructuring Proposal is approved. The standard terms and conditions applicable to different classes of borrowers are set out in Annexure-IV."

82. As per Clause 7.3, "Referring Institution should incorporate all applicable standard terms and conditions in the restructuring package, besides special conditions deemed necessary in specific cases..." Annexure IV in paragraph A (1) to (28), provides standard conditions for all four category of borrowers.

83. Paragraph B imposes "Additional Conditions for Borrower Class

- □B' (In addition to Standard Conditions Stipulated Under A)". Paragraph C imposes "Additional conditions for Borrower Class - □C' (In addition to Standard Conditions Stipulated Under A & B)".

Paragraph D imposes "Additional conditions for Borrower Class - □D' (In addition to Standard Conditions Stipulated under A, B & C)". Thus, the lower the Class assigned, the higher the conditions are to be placed.

84. As per Clause 8.1, "A decision of the CDR Empowered Group relating to prima facie feasibility and/or final approval of Restructuring Scheme shall be taken by a Super-Majority Vote at a duly convened meeting, after giving reasonable notice, to the Lenders and to the Eligible Borrower."

85. As defined in Clause 8.3, „Super-Majority Vote means not less than 60 per cent of number of lenders holding not less than 75 per cent of aggregate Principle Outstanding Financial Assistance.

86. On admission of Flash Report, as per Clause 9.3, "the borrower should open a current account with the MI (Monitoring Institution) to be designated □pre-TRA account..." and the procedure for which is described in Clauses 9.3 (i) to (xiii).

87. Clause 10 provides for a "Monitoring Mechanism" to ensure success of CDR mechanism and provides for an exhaustive process for proper implementation of the restructuring scheme. Clause 22 provides for criteria and procedure for exit from CDR.

88. After the TEV Report is made by an "independent agency" and an independent auditor conducts a Stock Audit of the company (both appointed by banks/ consortium of banks), the bank/ consortium of banks then commission the preparation of FRS, which is deliberated and approved by the banks and such approved FRS is submitted to the CDR- EG for its approval.

89. As per Clause 10.9, pursuant to the approval of CDR package by the CDR-EG, MRA and TRA are drawn, deliberated and signed between the company and the banks. This implements/ puts in effect the CDR package for a borrower company.

Whether the show cause notice was issued after inordinate and unexplained delay?

90. From the Form-32 submitted by the petitioner with the RoC, it is an admitted fact that the petitioner had resigned as Director of MBIL on 16.11.2012. This fact was admitted by the respondent-Bank in order dated 8.9.2022 passed by this Court in Ratul Puri v. Bank of Baroda43, wherein, it was recorded as under:-

> "7. Petitioner had in fact, resigned from the directorship of MBIL and MBSL w.e.f. 16th November, 2012 as mentioned in Form-32, annexed as Annexures P-6 and P-4 in W.P.(C) 12736/2022 and W.P.(C) 12737/2022, respectively. Mr. Sharma does not dispute the above fact and states that the date of filing with MCA/ROC is 29th September, 2012, as noted in order dated 19th August, 2022 passed by the Identification Committee.
>
> 8. From the above-noted facts, it emerges that Petitioner's resignation from directorship of MBIL is not a disputed fact. Petitioner was also not a party to the

proceedings before DRT is also uncontroverted..."

91. The allegation of investments by MBIL in its subsidiaries pertains to the period prior to the resignation of the petitioner as a Director. Hence, the learned counsel for the respondent-Bank was asked by this Court to explain the reason for issuance of show cause notice on 13.3.2020 to the petitioner i.e., after almost eight years since the petitioner exited MBIL.

92. The learned counsel for the respondent-Bank responded by contending that the bank became aware of huge diversion of funds in the subsidiaries of MBIL, only after it obtained a copy of the Forensic Audit Report dated 3.6.2019. Accordingly, the respondent-Bank decided to issue show cause notice.

93. In view thereof, the first question for the consideration of this Court is, whether the respondent-Bank became aware of the investments made by MBIL in its subsidiaries, which according to the respondent- Bank amounts to diversion of funds, only after it got a copy of the Forensic Auditor Report in 2019.

94. It may be noted that in its counter affidavit to the Writ Petition at paragraph no.11, the respondent-Bank has admitted that it was "aware of the nature of investment and transaction."

95. Even otherwise, such a stand is belied by the documents on record. The respondent-Bank had sanctioned loan facilities in favour of MBIL by sanction letters dated 12.12.2006 and 24.4.2010. Both the loan sanction letters required MBIL to submit quarterly statements and audited balance sheets to the respondent-Bank. The investments in the subsidiaries were made by MBIL from 2006 onwards till 2010. The audited financial statements duly reflected the investments in the subsidiaries. It is, therefore, difficult to accept that the respondent-Bank became aware of the investments in subsidiaries, which now according to them, is an act of diversion of funds, only in 2019 after it obtained a copy of the Forensic Audit Report. It is equally difficult to accept that the respondent-Bank did not review the financial statements of MBIL.

96. There are other clear circumstances which establish that the respondent-Bank was aware of these investments. As required by the lender banks, MBIL had submitted its Flash Report dated 18.2.2012. In Clause 13(d) of the said Flash Report, MBIL stated that one of the reasons for the current financial problems was the inability of MBIL to realize the investments made in its two subsidiaries. Thus, the Flash Report of 2012 clearly recorded the factum of investments of MBIL in its subsidiaries.

97. During the course of consideration of the CDR Scheme of MBIL, a meeting of all the lender banks had taken place on 20.7.2012. The Minutes of the said Meeting records that MBIL had made investments in its subsidiaries and that there were constraints in realizing the investments due to financial stress.

98. The lender banks, including the respondent-Bank, subsequently issued the FRS, which is their own internal document. Clauses 1.3.2, 1.6.1 and 5.1 of the said FRS also clearly record that MBIL had

made investments in its subsidiaries. In Clause 5.2.1, it is acknowledged that "The Company had chalked out a clear-cut long term plan to strategically invest in R&D activities and to develop businesses around its core technological and commercial focus areas. In-line with its vision, it began making strategic investments year after year. These investments had been funded from the substantial Cash Surpluses generated by the company in earlier years - from FY-06 onwards and partially from FCCB issuance in FY-08."

99. An entire section in Clause 5.1.2 in the FRS is dedicated to the "Constrained Ability to Unlock Value from Investments in Subsidiaries under Present Circumstances and a □summary of the difficulties by (each of) its subsidiaries. "

100. Thus, the explanation of the respondent-Bank that it issued show cause notice on 13.3.2020, only after it became aware of the investments in subsidiaries through the Forensic Audit Report dated 3.6.2019 is not sustainable. It is evident that the respondent-Bank was aware of such investments all throughout and chose to issue show cause notice to the petitioner after an inordinate and unexplained delay of nearly eight years since the petitioner exited MBIL and more than ten years since MBIL made investments in its subsidiaries. Although, no limitation is assigned in the Master Circular to initiate proceedings of wilful default, it is settled principle of law that when no time is prescribed in a statutory scheme, the proceedings for issuance of show cause notice must be made within a reasonable time. In the case of SEBI v. Sunil Krishnan Khaitan44, the Hon ble Supreme Court reiterated the legal position that in the absence of limitation prescribed, the power under every enactment must be exercised within reasonable time. What is reasonable time depends upon the facts of each case. When a noticee takes an objection of inordinate delay in issuance of show cause notice, the authority must decide the same in objective manner. This prevents abuse of the power. The relevant paragraph of the said decision reads as under:-

> □82... The directions given in the aforesaid quotation should not be understood as empowering the authorities/Board to initiate action at any time. In the absence of any period of time and limitation prescribed by the enactment, every authority is to exercise power within a reasonable period. What would be the reasonable period would depend upon facts of each case, such as whether the violation was hidden and camouflaged and thereby the Board or the authorities did not have any knowledge. Though, no hard and fast rules can be laid down in this regard as determination of the question will depend on the facts of each case, the nature of the statute, the rights and liabilities thereunder and other consequences, including prejudice caused and whether third party rights have been created are relevant factor. Whenever a question with regard to inordinate delay in issuance of a show-cause notice is made, it is open to the noticee to contend that the show-cause notice is bad on the ground of delay and it is the duty of the authority/officer to consider the question objectively, fairly and in a rational manner. There is public interest involved in not taking up and spending time on stale matters and, therefore, exercise of power, even when no time is specified, should be done within reasonable time. This prevents miscarriage of justice, misuse and abuse of the power as well as ensures that the violation of the provisions are checked and penalised without delay, thereby effectuating the (2023) 2

SCC 643 purpose behind the enactment.

101. Thus understood, promptness of action is in itself a determinator of reasonableness and objectivity. An inordinate delay in issuance of show cause notice, despite knowledge, indicates arbitrariness and unreasonableness. From the point of view of fairness in administrative action, such a measure involves an element of shock to the noticee, who could not have anticipated such a delayed action after almost a decade, despite full disclosure. Unless properly justified, the objection of inordinate and unexplained delay must be tested on a strict scrutiny parameter. Applying the aforesaid test, this Court is of the view that the Identification Committee and the Review Committee did not objectively consider the objection of the petitioner that there is inordinate and unexplained delay in issuance of show cause notice since the respondent- Bank was all throughout aware of the investments made by MBIL in the subsidiaries. The respondent-Bank chose to issue show cause notice to the petitioner after an inordinate and unexplained delay of nearly eight years since the petitioner exited MBIL and more than ten years since MBIL made investments in its subsidiaries. Ordinarily, such inordinate and unexplained delay in issuance of show cause notice is sufficient to nullify the proceedings.

102. However, since there is an element of public interest involved with the Master Circular, this Court in the peculiar facts of the case, decided to consider the validity of the impugned order passed by the Review Committee on merits as well.

Whether the Petitioner committed wilful default within the meaning of Clause 2.1.3(b) and (c) of the Master Circular?

103. This brings us back to the primary issue i.e., whether the respondent-Bank has erred in declaring the petitioner as wilful defaulter on the ground that substantial investments were made by MBIL in its subsidiaries, which amounted to diversion of funds within the meaning of Clause 2.1.3(b) and (c) of the Master Circular.

104. Clause 3(a) of the Master Circular places an obligation on the Identification Committee to examine the evidence of wilful default. Clause 3(b) provides that if the Identification Committee "concludes" that an event of wilful default has occurred, it shall issue show cause notice.

105. This Court vide order dated 28.11.2023 had directed the respondent-Bank to place on record the evidence on which the Identification Committee concluded that event of wilful default has occurred warranting issuance of show cause notice.

106. In compliance of the aforesaid direction, the Minutes of Meeting dated 24.2.2020 of the respondent-Bank, was placed on record, which includes the name of MBIL, which is reproduced as under:

> □After discussions the committee directed to issue show cause notices to the company/firm/borrowers and its directors/ guarantors in the above accounts for declaring them as wilful defaulters. Account wise details are enclosed as per

Annexure-C.

107. In the Annexure to the said Minutes, in reference to the allegations against the petitioner, the only evidence noted is the Forensic Audit Report. Apart from reference to the Forensic Audit Report, there is no other document or reasoning recorded in the Minutes to conclude that an event of wilful default has occurred.

108. As discussed above, Clauses 3(a) and (b) of the Master Circular enjoin the Identification Committee to examine the evidence and conclude whether event of wilful default has occurred or not. The words "to examine" and "to conclude", in this Court s opinion, would require the banks to do so based on material and after due application of mind. These words reflect the process which must be followed by the banks in arriving at the conclusion of wilful default. In order to ensure that the process is just, fair and reasonable, due application of mind is essential. The banks should record brief reasons discussing the evidence and reaching the conclusion. Such is the mandate of Clauses 3(a) and (b) of the Master Circular. It is also in conformity with the principles of natural justice and avoids arbitrary exercise of power in issuance of show cause notice.

109. In the present case, the respondent-Bank merely referred to the Forensic Audit Report for issuance of the show cause notice. No reasons for reaching the conclusion of event of wilful default is recorded. The respondent-Bank has not referred to any of the preceding documents like the loan sanction letter, Flash Report, Minutes of lender banks, Minutes of CDR-EG, FRS etc., which had a material bearing on the issue of reaching the conclusion whether event of wilful default had occurred or not. The words "to examine", as noted above, essentially required the respondent-Bank to carefully consider the entire material before arriving at the conclusion of wilful default. Non-consideration of relevant material falls short of requirement of examination. This Court is, therefore, of the view that the respondent-Bank failed to discharge the obligations mandated under Clauses 3(a) and (b) of the Master Circular before issuing the show cause notice in the present case.

110. This Court shall now consider the validity of the impugned order passed by the Review Committee on merits. The respondent-Bank, on 13.3.2020, had issued the show cause notice to the petitioner as to why he should not be declared as a wilful defaulter under the Master Circular. The show cause notice outlined six allegations of wilful default. The relevant portion of the show cause notice is reproduced as under:-

> "Re: Show Cause Notice for declaring M/s. Moser Baer India Limited and its Director as Wilful Defaulters and Opportunity for Representation there against.
>
> We refer to your captioned account and write to inform you that due to non-payment of interest/instalment, account turned to Non- Performing assets in the books of the Bank on 30.09.2012. We further write to inform you that as per the directions of the Committee of Executives on Wilful Defaulters of our Bank and on scrutiny of your account based on your acts of omission and commission, deeds/ documents and writings, performed /executed by you, the Company and its directors be classified as Wilful defaulter as per guidelines of RBI on the following grounds:

1. MBIL has made substantial investment in subsidiaries and related entities amounting to Rs.1586.75 Cr as on 31.12.13. During the period from 01.04.013 to 31.03.15 provision and write off made amounting to Rs.287.03 Cr.

2. The company carried out substantial transactions with related parties (viz. Cubic Technology BV, Moser Baer Energy Ltd, Moser Baer Engineering and Construction Ltd, Moser Baer Entertainment, Moser Baer Infrastructure & Developers Ltd, Moser Baer Investment Ltd, Moser Baer Photovoltaic Ltd, Moser Baer SEZ Developers Ltd, Moser Baer Solar Ltd, Moser Baer Technologies Inc, Moser Baer Trust, Moser Baer Employee Sale, Om and & T.B.V.)

3. Debtors/ Advances related their subsidiary companies amounting to Rs.103.28 cr written off from 01.04.13 to 31.12.13 and Rs.78.68 cr written off from 01.01.14 to 31.12.14.

4. The company has a lease rent receivables of Rs.247.04 cr as on 31.03.15.

Out of which Rs.210.58 cr are receivable from Moser Baer Solar Ltd (MBSL) and Rs.36.45 cr from M/s Moser Baer Solar Ltd, the company has leased back as operating lease to M/s Moser Baer India Ltd (MBIL). MBSL has not used the utilities and MBSL should not have been taken the utilities on lease.

5. Company has maintained accounts with a large number of banks outside the consortium against the terms and conditions of CDR.

6. Application of Short Term fund for Long Terms Uses.

(Amt in Crs)

Particulars	31.03.2013	31.12.2013	31.12.2014	31.03.2015
Long Term Sources (B)	1256.57	1170.33	1046.54	1012.84
Long Term uses (A)	2172.64	2099.5	1796.83	1757.2
Diversion (A-B)	915.97	929.16	750.29	744.36

The above table shows that long term uses have exceeded the long term sources of funds.

111. In response to the aforesaid show cause notice, the petitioner filed its replies on different dates. The respondent-Bank, on 5.8.2021, conducted a personal hearing. After the personal hearing, the petitioner, on 4.9.2021, filed his written submissions. In the said written submissions, the petitioner gave his response to each of the six allegations of alleged wilful default enumerated in the show cause notice. The response to allegation no.1, with which this case is concerned was as under:

(iv) Submissions on merits in reply to the alleged events of default in SCN:

S. No.	Alleged events of Default	Wilful	My Reply
1	MBIL has made substantial investments in subsidiaries and related entities amounting to Rs.1586.75 Crores as on 31.12.13. During the period from 01.04.13 to 31.03.15, during FY 2003-11.		1. No investments were made from borrowed funds. All investments were made from internal accruals/ PE funds/FCCB and disclosed in audited financial statements
			provision and write off made amounting to Rs. 287.03 Crores. at the time of sanction of credit facilities on 24.04.2010 and no objections thereof were raised. 3. These were again evaluated during the approval of CDR and were not considered to be an event of wilful default.
			Rather, same were recognized as strategic investments in the FRS and a Non-disposal Undertaking was obtained by the Lenders.
			4. Alleged provisions/ write-off during 01.04.13 to 31.03.15 pertains to the period post my exit in 2012. Hence, it cannot be an event of declaring me a Wilful defaulter Thus, there was no wilful default till my association with MBIL.

112. In the aforesaid written submission, the petitioner submitted its defence with regard to all the six allegations including allegation no.1. With regard to allegation no.1 that - "MBIL has made substantial investments in subsidiaries and related entities amounting to Rs.1586.75 Crores as on 31.12.13. During the period from 01.04.13 to 31.03.15, provision and write off made amounting to Rs. 287.03 Crores.", the petitioner made four submissions. Firstly, no investment was made by MBIL in the subsidiaries from "borrowed funds" but from internal accruals PE funds/FCCB and which was disclosed to the respondent- Bank in audited financial statements during Financial Years (FYs) 2003-

11. Secondly, the investments were evaluated at the time of subsequent sanction of loan on 24.4.2010 and no objection regarding the same was raised. Thirdly, the investments were also evaluated by the lender banks at the time of formulation of the CDR Scheme, which duly recorded the factum of investments in the subsidiaries. The CDR Scheme did not record the investments as diversion but rather as strategic investments.

And lastly, it was contended that the alleged writing off of the investments in subsidiaries had taken place between 1.4.2013 to 31.3.2015 when the petitioner was not the Director of MBIL as he exited the company on 16.11.2012.

113. The petitioner has further substantiated the aforesaid four points in paragraph no.36 of his Written Submission, which reads as under:-

> "36. Allegation No.1: MBIL has made substantial investments in subsidiaries and related entities amounting to Rs. 1586.75 Crores as on 31.12.13. During the period from 01.04.13 to 31.03.15, provision and write off made amounting to Rs. 287.03 Crores:
>
> About this allegation, the undersigned submits as follows: -
>
> (i) Investments (net of realization) to the tune of about Rs 768.03 crore were made in existing optical media business, solar photovoltaic business, and other emerging technologies during the F.Y 2003-11.
>
> (ii) These investments were funded from internal accruals including PE funds, cash accruals and FCCB etc. to the tune of approx. Rs.

4304 crores during FY 2004-11. No borrowed funds from Lenders were used for said investments.

(iii) These investments are out of ambit of RBI modified circular dated 01.07.2015 on wilful default for the following reasons: -

> (a) MBIL made said investments out of its own said resources, and
>
> (b) No borrowed funds from Lenders were ever used for said investments, and

(c) No investments in any other company's equity/debt instruments were made. All the said investments were made in 100% subsidiaries of MBIL for which no permission of lender was required.

(d) Said investments were made for the businesses related to the business of the MBJL.

(iv) Said investments, were also known to the lenders at the time of grant of loans, as same were disclosed in the audited financial statements of MBIL from time to time under the headings, "Note No. J 5 - Non-current Investments" as is evident from relevant Schedule of such financial statements for the F.Y 2009 to 2012.

Copies of these audited financial statements were provided to the lenders from time to time as mandated under the terms and conditions of loan related documents and agreements. Even otherwise, aforesaid financial statements, being the public documents, were legally in the knowledge or the lenders. All the lenders had renewed the working capital and/or sanctioned term loans from time to time despite having full knowledge about said investments from time to time, as copies of said audited financial statements were also provided to the lenders during detailed appraisal process of the lenders.

(v) The Final Restructuring Scheme (FRS), as approved at the time of CDR after conducting audit and TEV study, admitted categorically that investments of Rs 540 Cr in its subsidiary HPVL, MI3SL, MBEL, & MB SEZ were strategic profitable investments out of substantial cash surplus from FY 2005-06 & FCCB in FY 2007-08. BOB sanctioned the restructuring of facilities of MBJL vide its letter dated 15.04.2013 shows that despite having complete knowledge of said investments, Bank of Baroda had approved incremental debt to MBIL. As mentioned above, even CBoI, MI, had given an additional loan of Rs 50 crore to MBIL for making investments in the NCD of its subsidiaries i.e., MBSL.

(vi) Alleged provisions/ write-off during 01.04.13 to 31.03.15 pertains to the period post my exit in 2012. Hence, same cannot be an event of declaring me wilful defaulter

(vii) Moreover, such provisions/ write-off ought to be incompliance with the provisions of the Companies Act read with Accounting Standard- 13.

Such provisioning / writing off is not an unusual financial practice, as same practice is also adopted by Lenders / financial institution, as is evident from the following statement of finance minister Ms. Nirmala Sitharaman justifying such practice: -

☐Provisions are made for NPAs as per the four-year provisioning cycle laid down by the RBL Upon full provisioning being done, banks write-off he fully provided NPA but continue to pursue recovery against the borrower. No loan is waived off

> (viii) Moreover, basis for such provisions/ write-off appears to be scrutinized by the statutory auditors at the time of statutory audit and by the Tax Authorities at the time of assessment done by them.

Details of such provisions/ write off were also tiled with NSE & BSE from time to time in the form of Quarterly Limited Review Report of MBlL.

(ix) It is understood that post CDR, day to day working of MBIL was monitored, controlled, and regulated by the Lenders through their stock auditors and concurrent auditors. Upon being required in JLM dated 06.05.2015, MBIL, vide its email dt. 04.07.2015 (Annexure 11) explained to CBoI about the purpose, rationale, and realization prospectus of said investments of Rs 585.12 Cr outstanding as on 31.12.14 net of provision of Rs 182.91 Crore.

(x) In their reports from time to time, concurrent auditors verified and stated about then existing investments and provisions for diminution in value of such investments in its subsidiaries, as is evident from paragraph 5 and 8 of report dated March 05, 2015, of concurrent auditor M/s Malhotra Chopra & Associates, Chartered Accountants for the period of October to December 2014.

(xi) To conclude there was no diversion / misuse of borrowed funds for making said investments in subsidiaries and alleged write off / provisions pertains to the period post my exit from MBIL in 2012. Thus, this allegation cannot be a ground to declare me a wilful defaulter."

114. The Identification Committee of the respondent-Bank passed an order dated 19.8.2022 declaring the petitioner as wilful defaulter. The Identification Committee exonerated the petitioner from alleged acts of wilful default with regard to allegation nos.2 to 6 made in the show cause notice. The Identification Committee held that the said allegations pertained to a period after the petitioner ceased to be a Director of MBIL.

115. However, in respect of allegation no.1, the Identification Committee observed that the petitioner was a whole time Director in MBIL. He was in complete control over the said company. When he felt that MBIL was in trouble; he took an easy route to exit the company. The petitioner was aware about the affairs of MBIL and the entire siphoning/ diversion of funds took place during this period. The CDR that was done subsequently was only an attempt by the lender banks to revive MBIL. The Identification Committee ultimately held that substantial investments were made in the subsidiaries of MBIL from the account of MBIL, which triggered a shortage of funds. This action amounts to diversion of funds as per Clauses 2.1.3(b) and (c) of the Master Circular. Accordingly, the petitioner was declared as a wilful defaulter. The relevant finding of the Identification Committee reads as under:

> "The Committee has perused his representation and point-wise reply and is satisfied with the facts that point No. 2 to 6 of SON pertains to the period after Mr. Ratul Puri's resignation. It may however be noted that substantial investments were made in subsidiaries and relating parties amounting to Rs.1556.75 Cr by the company until 31.12.2013. The account was NPA 30.09.2012. Mr Ratul Puri was whole time Director

of the Company till 30.04.2012 and director till 16.11.2012. It is very clear that Mr. Ratul Puri being the Whole time Director of the Company was in complete command and control of the company and when he felt that the company is in trouble and on the verge of NPA, Mr. Ratul Puri made an easy escape by resigning from the post of Whole time Director vide letter dated 30.04.2012 and the same was filed at MCA/ROC only on 29.09.2012. Thus, Mr Ratul Puri made deliberately changed his directorship status from whole time director to director by filing form no. 32 just one day before the account turned NPA. He has completely exited from the company after the account became NPA.

It is therefore imperative that Mr Ratul Puri was fully aware about the affairs of the company and the entire mismanagement and diversion/ siphoning took place during his period and the CDR was just attempt on the part of the banks to give a handholding to revive the company.

The Committee is of the view that since substantial investments of Rs. 1556.75 were made in subsidiaries and related parties from the account of the company which has triggered shortage of capitals and this action of the company falls in the diversion as per RBI guidelines under clause 2.1.3(b) & (C) diversion/siphoning of funds has been observed in the account which is an element of wilful defaulter and hence Committee decided to declare Mrs. Nita Puri and Mr. Ratul Puri director of M/s. Moser Baer India ltd as wilful defaulters.

The Company name is dropped from the wilful default process as the Company is under NCL T process.

The committee concludes that Mrs. Nita Purl and Mr. Ratul Puri directors of M/s. Moser Baer India Ltd be declared as wilful defaulters.

The Committee directs that this order be served upon Mrs. Nita Purl and Mr. Ratul Puri directors of M/s. Moser Baer India Ltd allowing them to file appeal/ represent against the order of COE within 15 days from the receipt of the order and the said representation, if any, be placed before the Review Committee on Wilful Defaulter for their consideration Ordered accordingly."

116. Against the aforesaid order of the Identification Committee, the petitioner, on 22.9.2022, filed a representation before the Review Committee. The petitioner contended that the Identification Committee has committed an error in declaring him a wilful defaulter attributing the investment in subsidiaries of MBIL as diversion of funds from the Master Circular. It was reiterated that the investments in the subsidiaries were made from the internal accruals of MBIL and the same was disclosed in the audited financial statements. The said investments were in knowledge of lender banks at the time of finalisation of the CDR and no objection by any lender bank was raised. The relevant part of the appeal reads as under:-

"Allegation 1:

MBIL has made substantial investments in subsidiaries and related entities amounting to Rs. 1586.75 Crores as on 31.12.13. During the period from 01.04.13 to 31.03.15, provision and write off made amounting to Rs. 287.03 Crores.

My Reply:

(i) To my knowledge, these investments were made from the internal accruals/PE funds/FCCB and disclosed in audited statements.

(ii) These investments were evaluated at the time of sanction of credit facilities and/or approval of CDR and no objections/ concerns were raised. Hence, it cannot be an event of declaring me a Wilful Defaulter.

(iii) The Forensic Audit is for 1.4.2013 to 31.3.2015 i.e., post my exit in 2012 thus no wilful default can be attributed to me."

117. The Review Committee, on 23.3.2023, passed the impugned order and confirmed the decision of the Identification Committee with the following findings:-

□5. Observation of Review Committee □.. The account of MBIL was under forensic audit w.e.f. 01.04.2012 to 31.03.2015. The forensic auditor in its report had observed that the company has made substantial investments in subsidiaries and related entities (one of which is MBSL) amounting to Rs.1586.75 Crores. It was further concluded that the said investment was made when Mr. Ratul Puri was the whole time director of MBIL. There are large number of 2 way transactions with the subsidiaries and related entities. Mr. Ratul Puri has been duly communicated vide the order dated 19.09.2022 of the Committee of the Executive that the other said allegations have been accepted and withdrawn by Committee of Executives. Thus, no comments is required to be given.

The Committee observed that Mrs. Nita Puri has not given any representation and hence the Committee confirms the decision of COE of wilful defaulter declaration. The Committee observed that most of the points raised in the representation by Mr. Ratul Puri have no merit and hence not considered.

The Review Committee observed that the COE has concluded that since substantial investments of Rs.1556.75 Crores were made in subsidiaries and related parties from the account of the company which has triggered shortage of capitals and this action of the company falls in the diversion as per RBI guidelines under Clause 2.1.3(b) & (c) diversion/siphoning of funds has been observed in the account which is an element of wilful defaulter and hence Review Committee confirm the order of COE of declaration of Mrs. Nita Puri and Mr. Ratul Puri director of M/s Moser Baer India Ltd. as wilful defaulters.

118. This Court has already held that the respondent-Bank was aware about the investments in the subsidiaries at all relevant times. Hence, the contention of the respondent-Bank that only after Forensic Audit Report of 2019, it became aware of the alleged event of wilful default, is not acceptable.

119. Now, the question is whether these investments amount to "diversion" and "siphoning" of funds as per Clauses 2.1.3(b) and (c) of the Master Circular. As discussed above, the definition of "diversion of funds" and "siphoning of funds" in Clause 2.2.1 and Clause 2.2.2 of the Master Circular makes it explicitly clear that the event of "diversion of funds" or "siphoning of funds" can take place only when the "borrowed funds" are deployed or used for a purpose other than for which the loan was sanctioned. In other words, the Master Circular is not triggered unless the allegation of "diversion" or "siphoning" pertains to borrowed funds from the bank. A bank has no jurisdiction to invoke the Master Circular unless the allegations pertain to funds borrowed from the bank. The said provision also places an obligation on the bank to make the judgment about "diversion of funds" or "siphoning of funds" based on objective facts and circumstances of the case.

120. The question regarding the source of the funds which were invested by MBIL in its subsidiaries is answered by the lender banks including the respondent-Bank in their admittedly "own document" i.e., the FRS.

121. The FRS, is a document prepared by the lender banks in the year 2012 before finalisation of the CDR Scheme. Clause 1.3.2 of the FRS records that MBIL has made investments in its subsidiaries. The constraints in realising the said investments are also discussed. In Clause 1.6.1, the FRS noted the inability of MBIL to realise the investments in the subsidiaries as a reason for the financial hardships. In Clause 1.6.5, the lender banks noted the contents of the Flash Report submitted by MBIL, which had disclosed the investments in the subsidiaries. Most importantly, in Clause 5.1.2, the lender banks noted that one of the reasons for poor performance of MBIL was constraints in realising the investments in the subsidiaries. The lender banks noted that MBIL had chalked out a clear strategy around its core technological and commercial areas. Accordingly, MBIL made strategic investments in its subsidiaries over the years. The investments in the subsidiaries by the MBIL are funded by its "substantial cash surplus" generated by MBIL in earlier years of FY 2006 and FY 2008. Initially, at the time of investments, the expected profitability from these investments was substantial. No one expected the unprecedented disruptions. Clause 5.1.2 of the FRS reads as under:-

> "5.1.2 Constrained ability to unlock value from investments in subsidiaries under present circumstances The company had chalked out a clear-cut long term plan to strategically invest in the R&D activities and to develop businesses around its core technological and commercial focus areas. In-line with its vision, it began making strategic investments year after year. These investments had been fully funded from the substantial Cash Surpluses generated by the company in earlier years - from FY-06 onwards and partially from FCCB issuance in FY-08.

> At the time of making these investments, the growth potential and expected profitability from its core businesses and these businesses were substantial - as were the access to capital for each of these businesses. No one had expected the unprecedented disruptions all these related businesses had come to face especially in FY-11."

122. Thus, the lender banks including the respondent-Bank, in their own internal document acknowledged that they were fully aware of the investments made by MBIL in its subsidiaries. The investments had substantial potential of high growth and profit. No one expected the unprecedented disruptions. These investments were made by MBIL from its substantial cash surpluses generated in earlier years of FY 2006 and FY 2008. It is, therefore, the lender banks own stand that the investments in the subsidiaries were made from the internal accruals/ cash surpluses of MBIL. In other words, the investments were not made from the borrowed funds.

123. In this view of the matter, there cannot be any applicability of the Master Circular. As discussed above, the jurisdiction under the Master Circular can be invoked only in respect of borrowed funds. The lender banks own internal document of FRS admits the knowledge of investments from the inception, as also the source of such investments being the cash surpluses of MBIL from previous years. The issuance of show cause notice in respect of allegation no.1, which does not pertain to borrowed funds, in itself is without jurisdiction.

124. The petitioner in his Written Submission dated 4.9.2021 filed before the Identification Committee and in his representation dated 22.9.2022 filed before the Review Committee, had explicitly taken a defence that the investments in the subsidiaries was in the knowledge of lender banks from the beginning. The said investments were not made from borrowed funds but from internal accruals of MBIL in previous years. However, neither the Identification Committee nor the Review Committee ever adverted to the same in their respective findings. The impugned order dated 23.3.2023, therefore, clearly failed to take into consideration relevant material and was passed without any application of mind. The finding of the Identification Committee, as confirmed by the Review Committee, regarding allegation no.1 to the extent that it holds that the investments by MBIL in its subsidiaries amounted to "diversion" and "siphoning" of funds within the meaning of the Master Circular is unsustainable.

125. This Court in the case of Aap Infrastructure (supra) has held that the Identification Committee and the Review Committee are required to refer to the reply filed by the borrower and deal with the same while rejecting the reply. This would show application of mind and compliance with principles of natural justice:-

> "12. Insofar as the plea of Mr. Nandrajog that the petitioner in his reply to show cause has admitted the allegations made against it is concerned, the same is not appealing. This I say so, for two reasons; firstly which has already been noted by me above that the copy of the order passed by the First Committee dated February 20, 2018 has not been given to the petitioner. Secondly, it is clear that both the Committees have neither considered nor dealt with the stand taken by the petitioner in its reply to the

> show cause notice. The said Committees or at least the Review Committee was required to refer to the reply and dealt with the same while rejecting the reply of the petitioner to the show cause notice. This would have been in compliance of principles of natural justice as reasons would indicate, application of mind, that too what were the relevant considerations for the authorities to reject the reply of the petitioner to the show cause notice."

126. The Kerala High Court, in similar circumstances, in the case of Ravis Exports v. Union of India45, had quashed a wilful defaulter order on the ground that the lender bank failed to consider the explanation offered by the borrower:-

> "21... The COE had not considered the reasons or explanation offered by the petitioners or their representatives while arriving at the decision in Ext.R4(d). In the communication issued as Ext.P19, the reasons for declaring the petitioners as wilful defaulters have not been specified, except by merely referring to the grounds stated in the show cause notice. The reply/ explanation submitted by the petitioners has not been independently considered. The Review Committee also failed to consider or assess the order of the COE independently and failed to appreciate the failure to serve the order of COE on the petitioners. It is also surprising to note that even the guarantors have been declared as wilful defaulters without discerning the distinction between the borrower and guarantor and whether the guarantors in the instant case fell within the category of guarantors who could be declared as wilful defaulters. Thus, Ext.P19 and Ext.P21 are bad in law."

127. There is another important aspect of the FRS. In Clause 1.3 of the FRS, there is a query - whether any action initiated by regulatory agencies; Areas of concern in the working of the company/group (if applicable). The lender banks have not outlined any concern in the working of MBIL in the said clause. In Clause no.1.3.1, a specific question was put - whether the lender banks found adverse movements of funds. The answer recorded by the lender banks was- "none". Thus, in the FRS, despite noting investments by MBIL in the subsidiaries, the lender banks consciously did not categorise them as "adverse flow of funds."

128. Further, the lender banks in Clause 1.6.5 of the FRS noted that the CDR-EG in its meeting held on 24.2.2012 had categorised MBIL in Class-B as per the CDR Master Circular. The Class-B is for -

> "Corporate/promoters affected by external factors and also having weak resources, inadequate vision, and not having support of professional management." Class-C applies to - "Over-ambitious promoters; and borrower-corporate which diverted funds to related/unrelated fields with/without lenders' permission." If the lender banks, while doing the CDR, had found the investments in subsidiaries as "diversion of funds", then it ought to have placed MBIL in Class-C and not in Class-B.

129. The learned counsel for the respondent-Bank contended that during the CDR process, no forensic audit was conducted and hence, the petitioner cannot take advantage of the fact that in the

CDR process, MBIL was placed in Class-B as per the CDR Master Circular.

130. This Court is unable to accept the said contention. The respondent-Bank in its counter affidavit at paragraph no.11 has admitted, and which is also borne out from other documents on record, that the lender banks including the respondent-Bank were all along aware of the investments made in the subsidiaries. The provisions of the CDR Master Circular in Clause 3 provide for scrutiny at the stage of CDR. The CDR Master Circular requires the lender banks to change the management of the company where there has been "diversion of funds". In case of "diversion of funds", wherever necessary, the banks may also carry out forensic audit of the company. The lender banks including the respondent-Bank neither sought the change of management nor sought the forensic audit. Clause 6 of the CDR Scheme proscribes the banks from entering into CDR where there is fraud or malfeasance. In the FRS, which is banks own internal document, the respondent-Bank, despite noting investment in subsidiaries, never categorized them as diversion of funds. Thus, the argument of the respondent-Bank, that the petitioner cannot rely on the fact that MBIL was placed in Class-B since at that stage no forensic audit was done, is devoid of any substance.

131. Clause 2.2.2 of the Master Circular requires the banks and its two Committees to decide cases of wilful default objectively; after application of mind and consideration of all relevant facts and circumstances of the case. The Committees are required to take into consideration the reply and explanation provided by the borrower in its response to the show cause notice. The lenders should then arrive at a "judgement", which should be reasonable and supported with reasons. The two Committees, in the present case, have failed to discharge the said burden and the impugned order has mechanically affirmed the order passed by the Identification Committee.

132. The learned counsel for the respondent-Bank has contended that MBIL did not take prior approval before making the investment in its subsidiaries. This Court is not impressed with the said argument. As discussed earlier, the respondent-Bank and other lenders were always aware of these investments. No document has been brought to the notice of this Court, wherein, the lender banks raised any objection to these investments at any stage. On the contrary, the FRS of lender banks appreciated the nature of these investments and found them to be potentially financially sound. Further, the question for seeking prior approval could only arise if the investments were made by borrowed funds. Since the FRS records that the investments were made from cash surpluses of MBIL, the question of MBIL seeking prior approval of the respondent-Bank before making the investments does not arise.

133. Further, as rightly pointed out by learned senior counsel for the petitioner, the respondent-Bank vide its letter dated 20.9.2007 had intimated to MBSL (where investments were made) that against MBSL s request for loan for Rs.439.21 Crores, the respondent-Bank could provide a loan of only Rs.292.82 Crore and the balance is to be raised by MBSL through its promoters. MBIL, being 100 percent parent company of MBSL, had infused the differential balance of about Rs.147 Crore by way of investments. The respondent-Bank being common lender of both MBIL and MBSL and having access to their audited balance sheets, was aware of such investments.

134. The Identification Committee and the Review Committee of the respondent-Bank has held that the investments in subsidiaries "triggered a shortage of capital" and therefore, the act of investment "falls in the diversion as per RBI guidelines under Clause 2.1.3(b) & (C) diversion/ siphoning of funds..."

135. Learned counsel for the petitioner contended that the aforesaid observation is totally misconceived and ignores the contents of the FRS. In Clause 5.1.2 of the FRS, the lender banks including the respondent- Bank recognized that the MBIL clearly had a long term plan to strategically make investments in core technologically and commercially focused business. In line of this, MBIL made investments in its subsidiaries. At the time of investment, the growth potential and expected profits were substantial. Subsequent unprecedented disruptions could not have been anticipated.. Further, in Clause 8.1(3), the lender banks had expressly restricted MBIL from selling "any of its fixed assets / investments" "without prior recommendation of the Monitoring Committee and approval of CDR EG". Thus, according to lender banks, the investments at the time when made, were strategic; had growth potential and expected profits. However, when the investments did not yield profits due to various factors, they were subsequently categorized as "diversion/siphoning". Such an approach cannot be countenanced. In any case, since the investments were not made from borrowed funds, the respondent-Bank could not have invoked the Master Circular to declare the petitioner as wilful defaulter.

136. In fact, the respondent-Bank being a party to the FRS itself ought to have been aware of the contents of the FRS, to which it was a signatory. With the knowledge of the contents of the FRS, there may not have been even an occasion to issue show cause notice with regard to allegation no.1. In the counter affidavit filed before this Court, the respondent-Bank in paragraph no.11 has admitted that FRS is bank s own document. While dealing with the Master Circular, which has civil and penal consequences, the respondent-Bank, particularly, being a public sector undertaking, ought to have been more vigilant.

137. The other part of allegation no.1 was that "During the period from 01.04.13 to 31.03.15, provision and write off made amounting to Rs. 287.03 Crores". This allegation, on the face of it, pertains to a period when the petitioner was no longer a Director of MBIL. Admittedly, he resigned as a full time Director on 16.11.2012 and exited MBIL. Thus, no act of wilful default can be attributed to the petitioner for the period when he was no longer the Director. In fact, in respect of allegation nos.2 to 6, the Identification Committee and the Review Committee exonerated the petitioner precisely on the point that the said allegations pertained post-resignation of petitioner as the Director. However, the Identification Committee and the Review Committee failed to apply the same yardstick to the second part of allegation no.1, which also pertained to a period when the petitioner was no longer a Director and no longer associated with MBIL. Thus, the second part of allegation no.1 also suffers from non-application of mind and cannot be sustained.

138. The learned counsel for the petitioner has also placed reliance on Clause 17-19 of Accounting Standard 13 (AS-13) by the Institute of Chartered Accountants to contend that it is a recognized accounting practice to write off decline in the value of long term investment. It is contended that while considering the allegation of writing off of the investment, the respondent-Bank ought to have

taken into consideration standard accounting practices. The relevant Clause reads as under:-

> "Long-term Investments:
>
> 17. Long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. The type and extent of the investor's stake in the investee are also taken into account. Restrictions on distributions by the investee or on disposal by the investor may affect the value attributed to the investment.
>
> 18. Long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis.
>
> 19. Where there is a decline, other than temporary, in the carrying amounts of long term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist."

139. Learned counsel for the respondent-Bank is unable to refer to any document on record that while considering the evidence of wilful default, the standard accounting practices were taken into consideration. In any case, the respondent-Bank has not been able to point out as to how the petitioner got benefitted from such writing off when he was neither a director nor shareholder of either MBIL or the subsidiaries at the time of writing off between 2013 to 2015. The writing off of the investments in the subsidiaries, under the scheme of the Master Circular, may become relevant only when it is proved that the investments were made from the borrowed funds. Since it is an admitted position that the investments were made from cash surpluses of MBIL, the writing off of the investments, cannot, by itself, be regarded as an act of wilful default.

140. Clause 2.1.3 of the Master Circular provides that to declare a person as wilful defaulter, the lender banks should bear in mind that to categorise a default as "wilful", the same must be intentional, deliberate and calculated. This court finds that the Identification Committee as well as the Review Committee failed to discharge this burden objectively. On the contrary, rather than being intentional, deliberate and calculated, the lender banks in the FRS in Clause 5.1.2, as noted above, found that at the time of making the investments, the growth potential and expected profitability from them was substantial. Thus, at the time of making these investments, the lender banks found them to be financially very sound. If that were so, the same, subsequently cannot be categorized as acts of wilful default which were intentional, deliberate and calculated.

141. It is also not out of place to mention that the PNB and SBBJ, who are also lender banks to the petitioner, had issued show cause notices making similar allegations. After considering the explanation of the petitioner, both these banks dropped the wilful default proceedings against the petitioner.

142. Much emphasis has been laid by learned counsel for the respondent-Bank on the point that just when MBIL was about to be declared as NPA, the petitioner took an easy route and resigned as the Director of MBIL. He, therefore, contends that the resignation of petitioner should not be given much importance as the same was a calculated and deliberate move. This Court is unable to attach any significant importance to this argument. Indisputably, the Indian Companies Act, 2013 permits a Director to resign as the Director of a company. The act of resignation is not an act of wilful default under the Master Circular. The learned counsel for the respondent-Bank is not able to demonstrate to this Court any act of wilful default within the meaning of Master Circular when the petitioner was Director of MBIL.

143. Further, as discussed above, the respondent-Bank was aware about the exit of the petitioner from MBIL. The respondent-Bank carried out the entire CDR proceedings without petitioner s presence in MBIL. It was always open to the respondent-Bank and other members of the consortium banks to refuse CDR if the petitioner s continuation was felt vital. To now contend in hindsight that the petitioner took an easy route to exit MBIL when it was about to default, does not advance the cause of the respondent-Bank in any manner. The mere factum of resignation as the Director, when MBIL was not performing well, cannot be a ground to declare him as wilful defaulter.

Contents and effect of Forensic Audit Report

144. This brings this Court to consider the effect of the Forensic Audit Report dated 3.6.2019. As recorded above, this Court, vide order dated 28.11.2023 had directed the parties to place on record the document which showed the satisfaction arrived at by the respondent-Bank to issue show cause notice to the petitioner. The petitioner, on 16.12.2023, placed on record a compilation annexing Minutes of Meeting dated 24.2.2020, wherein, the decision to issue show cause notice to the petitioner was taken. In the said Minutes, it is recorded that the decision to issue show cause notice is taken on the basis of the Forensic Audit Report. In the column "Document/ Evidence", which proved the event of wilful default, it is mentioned "Forensic Audit Report of M/s GSA and Associates". Thus, the whole basis for issuance of show cause notice to the petitioner is the Forensic Audit Report dated 3.6.2019.

145. However, the show cause notice issued to the petitioner does not make any reference to the Forensic Audit Report. Admittedly, even the copy of the Forensic Audit Report was supplied by the respondent-Bank to the petitioner, after the issuance of the show cause notice.

146. The petitioner has contended that the respondent-Bank, for the first time, has sought to place reliance on the Forensic Audit Report in the counter affidavit filed before this Court. The respondent-Bank cannot justify its Review Committee order on the basis of pleadings and documents which did not form part of the show cause notice. It is contended that the validity of an

order has to be adjudged on the basis of reasons assigned therein and not by subsequent explanations by way of affidavits. In support of the said contention, the petitioner has placed reliance on the decisions of the Hon ble Supreme Court in Mohinder Singh Gill v. Chief Election Commissioner46, Rashmi Metaliks Ltd. v. Kolkata Metropolitan Development Authority47, Dipak Babaria v. State of Gujarat48 and State of Punjab v. Bandeep Singh49.

147. There can be no quarrel with the aforesaid proposition. However, since the respondent-Bank is a public sector bank and deals with public funds, this Court decided to consider the contents and effect of the Forensic Audit Report.

148. As discussed above, Clauses 2.1.3(b) and (c) read with Clauses 2.2.1 and 2.2.2 of the Master Circular, "diversion" and siphoning" can be triggered by a bank only in respect of the borrowed funds. The respondent-Bank has tried to justify its show cause notice and orders passed by the Identification Committee and Review Committee on the basis of the Forensic Audit Report.

149. However, a perusal of the Forensic Audit Report, specially Clause D(iv), reveals that the said Report has clarified that the source of funds of investments made in subsidiaries was not verified in the Forensic Audit Report as the same were made prior to the period of review. The relevant portion of Forensic Audit Report is reproduced as under:-

> (1978) 1 SCC 405 (2013) 10 SCC 95 (2014) 3 SCC 502 (2016) 1 SCC 724 □v. Please further note that source of funds of the investments made by the company in its subsidiaries, associates and joint ventures were not verified by us as these investments were made before our period of review .

150. Thus, the Forensic Audit Report did not verify the source of funds which were invested in the subsidiaries. The respondent-Bank, could not have issued show cause notice to the petitioner for wilful default, without verifying the source of funds that were invested. Unless the funds that were invested were found to be borrowed funds, the respondent-Bank did not have jurisdiction to invoke the Master Circular. The very genesis of "diversion" or "siphoning of" funds is dependent on the funds being borrowed funds. The reliance placed by the respondent- Bank on the Forensic Audit Report is clearly misconceived. The Forensic Audit Report does not record any conclusion regarding diversion or siphoning of funds qua the petitioner. The reliance placed by the respondent-Bank on the Forensic Audit Report to issue show cause notice of wilful default to the petitioner is clearly misplaced.

Consequences of admitting MBIL for CDR under the CDR Scheme

151. Before parting, this Court deems it apposite to make certain observations regarding the scheme of the CDR Master Circular. The CDR Master Circular is equipped with several measures to ensure that cases involving frauds or diversion of funds with mala fide intent are not admitted for CDR.

152. These include provisions like Clause 6.3 read with paragraph no.4 of Annexure III, which renders corporates indulging in fraud and malfeasance as ineligible for CDR. Further, CDR scheme

provides for four Classes - A to D, out of which Categories C and D relate to cases of diversion of funds and the said categorisation has to be done by the lenders on their own.

153. The classification has a direct bearing on eligibility as also the conditions to be imposed upon the borrower. The lower the category, the more stringent the conditions to be imposed upon a borrower in accordance with paragraphs C and D of Annexure IV. Significantly, "Before CDR Reference/Approval", Clause 3.3 of CDR Scheme expressly empowers banks to commission a Forensic Audit "wherever necessary and specially in cases of diversion of funds. "

154. The aforesaid provisions in the CDR scheme lead to the conclusion that the categorization of a borrower in one of the categories between A and D has to be based on an objective satisfaction.

155. This Court is of the view that it is incumbent upon banks who are dealing with public funds and discharging a public duty to make appropriate enquiries as to whether a borrower is in genuine financial difficulty or whether there exists any event(s) of fraud and malfeasance. If the lender banks find fraud or malfeasance, the CDR-EG must either refuse CDR completely or impose such additional onerous conditions as provided in the CDR Scheme itself.

156. In the present case, the lender banks were aware of the investments made by MBIL in its subsidiaries. This fact is part of the documents leading to the finalization of the CDR scheme. The investments were treated as strategic with growth potential and expected profits. The investments were found to have been made from the cash surpluses of MBIL. The lender banks did not find these investments as diversion or siphoning of borrowed funds. The lender banks placed MBIL in Class-B of CDR Master Circular which cannot be assigned if there is diversion of funds. They found no occasion to order a forensic audit of MBIL either before finalization of CDR scheme or after its failure. The lender banks, therefore, never treated the investments in subsidiaries as an act of diversion or siphoning either during finalization of the CDR scheme or after its failure.

157. In view of the aforesaid discussion, the reasons assigned in the impugned order dated 23.3.2023 passed by the Review Committee confirming the petitioner as wilful defaulter under the Master Circular are unsustainable and therefore, the impugned order is accordingly quashed and set aside. The petition is allowed in the aforesaid terms and disposed of alongwith pending application(s), if any.

(PURUSHAINDRA KUMAR KAURAV) JUDGE MARCH 01, 2024/p/p'ma