

# Hemant Kanoria vs Karnataka Bank Limited & Ors on 15 May, 2023

**Author: Satish Chandra Sharma**

**Bench: Chief Justice, Subramonium Prasad**

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IN THE HIGH COURT OF DELHI AT NEW DELHI  
W.P.(C) 7579/2022 & CM APPL. 23310/2022  
HEMANT KANORIA

KARNATAKA BANK LIMITED & ORS

CORAM:

HON'BLE THE CHIEF JUSTICE

HON'BLE MR. JUSTICE SUBRAMONIUM PRASAD  
ORDER

% 15.05.2023

1. The Petitioner before this Court has filed the present petition under Article 226 of the Constitution of India challenging the constitutional validity of the RBI's Master Circular on 'Frauds - Classification and Reporting' by Commercial Banks and Selected Financial Institutions dated 01.07.2016. The contention of the Petitioner is that without following the principles of natural justice & fair play, the account of the Respondent Nos.3 and 4 has been declared as 'Fraud' and the Petitioner was Director of the Company at the relevant point of time. The Petitioner has prayed for the following reliefs:

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The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 20/09/2023 at 08:21:26 "a. Issue a writ of certiorari, or any other appropriate writ, order or direction, quashing the Circular bearing No. RBI/ DBS/ 2016-17/ 28 DBS. CO. CFMC. BC. No. 1/ 23.04.001/ 2016-17, dated 01.07.2016, updated as on 03.07.2017, issued by the Respondent No.2 inasmuch as it is vague,

does not follow the basic principles of natural justice and violative of Article 14 of the Constitution of India;

b. Issue a writ of Mandamus, or any other appropriate writ, order or direction, thereby declaring that the Impugned Action of Respondent No. 1 Bank of declaring the account of the Respondent Nos. 2 & 3 as 'fraud' (pursuant to the Impugned Circular dated 01.07.2016) as illegal, invalid, null and void;

c. Issue a Writ of Mandamus or any other appropriate writ, order or direction quashing any steps/action taken pursuant to the Impugned Action of declaring the Petitioner's account as "fraud";

d. Issue a writ of Mandamus, or any other appropriate writ, order or direction staying further actions or steps pursuant to the Impugned Action of declaring the Petitioner's account as fraud;

e. Issue a writ of Mandamus, or any other appropriate writ, order or direction, against the other Creditors/ Banks of Respondent no.3 and 4 from declaring the account of the Respondent Nos. 3 & 4 as 'fraud' (pursuant to the Impugned Circular dated 01.07 .2016) as illegal, invalid, null and void and from taking any coercive steps in that regard;

f. Pass any other order(s) as this Hon'ble Court may deem fit and proper in the facts and circumstances of the case. "

2. While the matter was being argued, learned Counsel, at the outset, has drawn the attention of this Court towards the judgment delivered by the This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 20/09/2023 at 08:21:26 Apex Court in the case of State Bank of India & Others Vs. Rajesh Agarwal & Others, Civil Appeal No.7300/2022, and other connected matters. The Civil Appeals decided by the Hon'ble Supreme Court arose out of a judgment passed by the High Court of Telangana, wherein the Petitioners therein challenged the vires of the Reserve Bank of India (Frauds Classification and Reporting by Commercial Banks and Select Financial Institutions) Directions 2016, issued by the Reserve Bank of India. The High Court of Telangana has held in the impugned judgment that the principles of natural justice must be read into the provisions of the Master Directions on Frauds.

3. The decision of the High Court of Telangana was assailed by the RBI and lender Banks before the Hon'ble Supreme Court. It was held by the Hon'ble Supreme Court 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. It was so held that as 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. It was held that the administrative proceedings which entail significant civil consequences must be read consistent with the principles of natural justice to meet the requirement of Article 14. Where possible, the rule of audi alteram partem ought to be read into a statutory rule to render it

compliant with the principles of equality and non-arbitrariness envisaged under Article 14. The Master Directions on Frauds did not expressly provide the borrowers an opportunity of being heard before classifying the This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 20/09/2023 at 08:21:27 borrower's account as fraud. The Hon'ble Supreme Court, therefore, held that the principle of audi alteram partem must then be read into the provisions of the Master Directions on Frauds.

4. Thus, to summarise, the Hon'ble Supreme Court in its judgment has held as under:

- (i) No opportunity of being heard is required before an FIR is lodged and registered against the borrower;
- (ii) Classification of an account as fraud not only results in reporting the crime to investigating agencies, but also has other penal and civil consequences against the borrowers;
- (iii) Debarring the borrowers from accessing institutional finance under Clause 8.12.1 of the Master Directions on Frauds results in serious civil consequences for the borrower;
- (iv) Such a debarment under Clause 8.12.1 of the Master Directions on Frauds is akin to blacklisting the borrowers for being untrustworthy and unworthy of credit by banks. This Court has consistently held that an opportunity of hearing ought to be provided before a person is blacklisted;
- (v) The application of audi alteram partem cannot be impliedly excluded under the Master Directions on Frauds. In view of the time frame contemplated under the Master Directions on Frauds as well as the nature of the procedure adopted, it is reasonably practical for the lender banks to provide an opportunity of a This is a digitally signed order.

The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 20/09/2023 at 08:21:27 hearing to the borrowers before classifying their account as fraud;

(vi) The principles of natural justice demand that the borrowers must be served a notice, given an opportunity to explain the conclusions of the forensic audit report, and be allowed to make representations before the banks/ JLF before their account is classified as fraud under the Master Directions on Frauds. In addition, the decision classifying the borrower's account as fraudulent must be made by a reasoned order; and

(vii) Since the Master Directions on Frauds do not expressly provide an opportunity of hearing to the borrowers before classifying their account as fraud, audi alteram partem has to be read into the provisions of the directions to save them from the vice of arbitrariness.

5. Paragraphs 81 to 83 of the order passed by the Hon'ble Supreme Court reads as under:

"81. The conclusions are summarized below:

- i. No opportunity of being heard is required before an FIR is lodged and registered;
- ii. Classification of an account as fraud not only results in reporting the crime to investigating agencies, but also has other penal and civil consequences against the borrowers;
- iii. Debarring the borrowers from accessing institutional finance under Clause 8.12.1 of the Master Directions on Frauds results in serious civil consequences for the borrower;

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The authenticity of the order can be re-verified from Delhi High Court Order Portal by scanning the QR code shown above. The Order is downloaded from the DHC Server on 20/09/2023 at 08:21:27 iv. Such a debarment under Clause 8.12.1 of the Master Directions on Frauds is akin to blacklisting the borrowers for being untrustworthy and unworthy of credit by banks. This Court has consistently held that an opportunity of hearing ought to be provided before a person is blacklisted;

v. The application of audi alteram partem cannot be impliedly excluded under the Master Directions on Frauds. In view of the time frame contemplated under the Master Directions on Frauds as well as the nature of the procedure adopted, it is reasonably practicable for the lender banks to provide an opportunity of a hearing to the borrowers before classifying their account as fraud;

vi. The principles of natural justice demand that the borrowers must be served a notice, given an opportunity to explain the conclusions of the forensic audit report, and be allowed to represent by the banks/JLF before their account is classified as fraud under the Master Directions on Frauds. In addition, the decision classifying the borrower's account as fraudulent must be made by a reasoned order; and vii. Since the Master Directions on Frauds do not expressly provide an opportunity of hearing to the borrowers before classifying their account as fraud, audi alteram partem has to be read into the provisions of the directions to save them from the vice of arbitrariness.

82. In the result, the judgment of the Division Bench of the High Court of Telangana dated 10 December 2020 is upheld. The judgments of the High Court of Telangana dated 22 December 2021 and 31 December 2021, and of the High Court of Gujarat dated 23 December 2021 are accordingly set aside. The Civil Appeals are disposed of. Writ Petition (C) No. 138 of 2022 is also disposed of in above terms. There shall be no order as to costs.

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83. Pending application(s), if any, shall stand disposed of."

6. In light of the aforesaid judgment passed by the Hon'ble Supreme Court, as argued by the learned Counsel for the Petitioner, no opportunity of hearing was granted to the Petitioner and the aforesaid fact has not been controverted by learned Counsel for the Respondent No.1 Bank.

7. Accordingly, the order declaring the account of Respondent Nos. 3 and 4 herein as 'Fraud' is hereby set aside. However, liberty is granted to the Respondent No.1 Bank to proceed ahead in accordance with law in light of the judgment delivered by the Hon'ble Supreme Court.

8. The petition stands disposed of in the aforesaid terms along with the pending applications.

SATISH CHANDRA SHARMA, CJ SUBRAMONIUM PRASAD, J MAY 15, 2023 hsk This is a digitally signed order.

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