

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD
R/SPECIAL CIVIL APPLICATION NO. 19008 of 2022

FOR APPROVAL AND SIGNATURE:

HONOURABLE MS. JUSTICE SANGEETA K. VISHEN

Sd/-

1	Whether Reporters of Local Papers may be allowed to see the judgment ?	No
2	To be referred to the Reporter or not ?	No
3	Whether their Lordships wish to see the fair copy of the judgment ?	No
4	Whether this case involves a substantial question of law as to the interpretation of the Constitution of India or any order made thereunder ?	No

AMIT DINESHCHANDRA PATEL
 Versus
 RESERVE BANK OF INDIA

Appearance:

MR MIHIR THAKORE, SR. COUNSEL WITH MS RHEA J. SEVAK for
 MR ARJUN R SHETH(7589) for the Petitioner(s) No. 1,2
 MR DHRUVKUMAR S CHAUHAN(8138) for the Respondent(s) No.
 10,11,12,13,14,2,5,6,7,8,9
 MR A J SAIYAD(11479) for the Respondent(s) No. 16
 MR AMAR N BHATT(160) for the Respondent(s) No. 1
 MR ANIP A GANDHI(2268) for the Respondent(s) No. 18
 MR K I KAZI(5030) for the Respondent(s) No. 16
 MR LALIT M PATEL(2239) for the Respondent(s) No. 4
 MR S. N. SOPARKAR, SR. COUNSEL WITH MR MASOOM K SHAH(6516)
 for the Respondent(s) No. 20
 MS AB CHATURVEDI(5419) for the Respondent(s) No. 17
 NOTICE SERVED BY DS for the Respondent(s) No. 15,19,3

CORAM: HONOURABLE MS. JUSTICE SANGEETA K. VISHEN

Date : 02/01/2024
ORAL JUDGMENT

1. The petitioners are aggrieved by the decision of the respondent banks taken in the Joint Lenders Meeting dated 29.09.2020 declaring the account of M/s Syntex Industries Limited

(hereinafter referred to as “the Company”) as fraud.

2. Facts, in brief, are that, the petitioners are the promoters, suspended directors and share holders of the company. Company vide order dated 06.04.2021 is currently in the Corporate Insolvency Resolution Process (CIRP) under the provisions of Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as “the Code of 2016”). It is around 04.07.2020, the company came to know about the South Indian Bank i.e. a member of the consortium banks i.e. respondent nos.3 to 19 having taken steps to notify fraud in relation to the loan account of the company.

2.1 It is the case of the petitioners that meetings were convened on 18.08.2020 and 29.09.2020 and during that period, forensic audit reports dated 11.08.2020 and 18.09.2020 were discussed. Also, issues were discussed including the issue about the account being declared as a fraud by the South Indian Bank. In the meeting dated 29.09.2020 on the basis of the forensic audit report dated 11.08.2020 and supplementary forensic audit report dated 18.09.2020, the account of the company was declared as fraud illegally. Moreover, the petitioners have learnt about the said declaration of fraud by the Punjab National Bank, Punjab & Sind Bank, Karnataka Bank Limited on 30.09.2020, 24.12.2020 and 09.10.2020 respectively. Writ petitions, were filed before the Hon’ble Delhi High Court challenging the action of declaration of fraud by the respondent banks and the Hon’ble Delhi High Court was pleased to stay the operation and implementation of the declaration of fraud. Various other connected writ petitions were also filed challenging the action of the purported declaration of fraud by the respondent banks. All the proceedings were withdrawn, without prejudice to the rights and contentions of the petitioners

and with a liberty to avail other remedies in law and hence the captioned writ petition.

3. Mr Mihir J. Thakore, learned senior counsel with Ms Rhea J. Sevak, learned advocate for the petitioners submitted that in the consortium meeting held on 18.08.2020, the petitioner no.1 being the promoter and director was present, followed by the meeting dated 29.09.2020. It is submitted that the draft forensic audit report and supplementary forensic audit report were discussed with the member banks and they were of the view that the account of the company, shall be declared as a fraud on the basis of finding and opinion of the forensic auditor. It is submitted that all the member banks agreed in principle to declare the account of the company as a fraud and the main reason behind declaring the account of the company as a fraud was based on the forensic audit report dated 11.08.2020 and supplementary forensic audit report dated 18.09.2020 namely, (i) Breach of trust, sudden disappearance of stock etc.; (ii) Misfeasance; (iii) Embezzlement; (iv) Misappropriation of funds / Diversion of funds outside the borrowing units etc. and (v) Siphoning off funds through fake telegraphic/mail transfers. It is submitted that the Punjab National Bank i.e. respondent no.2 has addressed a communication dated 30.09.2020 to the stock exchange, *inter alia*, pointing out that fraud of Rs.1203.26 crores is being reported by the bank to the Reserve Bank of India in the accounts of the company which, was according to the bank, was disclosure under Regulation 30 of the Securities Exchange Board of India (LODR) Regulations, 2015.

3.1 It is submitted that it is not in dispute that the copies of the forensic audit report dated 11.08.2020 including supplementary forensic audit report dated 18.09.2020 which were the basis for

declaring the account of the company as fraud were never supplied to the petitioners and what was shared, was the observations of the draft forensic audit report to the petitioners. Reliance is placed on the judgment in the case of *State Bank of India and Others v. Rajesh Agarwal and Others* reported in (2023) 6 SCC 1. It is submitted that Master Directions of 2016 were challenged before the different High Courts primarily on the ground that no opportunity of being heard is envisaged to the borrowers before classifying their accounts as fraudulent. The issue before the Apex Court was whether the principles of natural justice should be read into the provisions of the Master Directions of 2016 on Frauds. Apex Court has held and observed 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. The Apex Court has further held that rule of audi alteram partem ought to be read into Clauses 8.9.4 and 8.9.5 of the Master Directions on Frauds. Consistent with the principles of natural justice, the lender banks should provide an opportunity to a borrower by furnishing a copy of the audit reports and allow the borrower a reasonable opportunity to submit a representation before classifying the accounts as fraud. The Apex Court has also pointed out that a reasoned order has to be issued on the objections addressed by the borrower.

3.2 It is therefore submitted that admittedly and undisputedly, the principles of natural justice and more particularly, the rule of audi alteram partem, has not been observed in the present case. It is therefore submitted that on this limited ground, the decision of the respondent banks deserves to be quashed and set aside.

4. Mr Dhruvkumar S. Chauhan, learned advocate appearing for

respondent nos.2, 5 to 14 (hereinafter referred to as “respondent lender banks”), submitted that various meetings of the joint lenders were called wherein, officials of the company were present. It is submitted that the petitioners had filed suit before the Civil Court, Kalol which was not entertained on the ground that it is not maintainable. Aggrieved, the petitioners have preferred an appeal which also came to be disposed of. The petitioners also have approached Hon’ble Delhi High Court; however, the writ petitions before the Hon’ble Delhi High Court have been withdrawn reserving a liberty to avail of other remedies and therefore, the captioned application.

4.1 It is next submitted that the officials of the petitioners had remained present in the consortium meeting held on 05.07.2019 which fact, is not in dispute. Even in the communication dated 04.06.2020, the petitioners were made clear about agenda items which were proposed to be discussed in the meeting and one of the agendas, was presentation on forensic audit report by M/s G. D. Apte and Associates and discussion on the draft forensic audit report. The meeting was convened on 10.06.2020 when again, the officials of the petitioners company were present. It is thereafter on 13.08.2020, again the communication was addressed to all the concerned for the meeting to be convened on 18.08.2020 and one of the items to be discussed was final forensic audit report received from M/s G. D. Apte & Associates. The promoters, directors along with the company officials were present and therefore, it is not correct on the part of the petitioners to contend that they were not offered any opportunity to discuss and consider the forensic audit report.

4.2 While relying upon the Master Direction – Reserve Bank of

India (Transfer of Loan Exposures) Directions, 2021, it is submitted that it will apply to the respondent no.20 and owing to the assignment deed executed, it will be the respondent no.20 who would now be taking steps against petitioners.

5. Mr S. N. Soparkar, learned senior counsel with Mr Masoom K. Shah, learned advocate appearing for respondent no.20, has vehemently opposed the stand taken by the respondent lender banks it being incorrect for, vide order dated 06.04.2021, the Tribunal was pleased to admit the company into the Corporate Insolvency Resolution Process (CIRP) under the provisions of the Code of 2016. Respondent no.20 is an Asset Reconstruction Company which was one of the successful resolution applicants in the CIRP of company. As a result of the proceedings before the Tribunal, that the respondent no.20 and the company have mutually agreed that respondent no.20 shall extinguish the balance financial debt. Pursuant to which, an 'Agreement for Extinguishment of Debt', came to be executed whereby, the balance financial debt was extinguished. Therefore, so far as respondent no.20 is concerned, it has no relationship of the lender and the borrower. Hence, respondent no.20, has no role to play. It is further submitted that the respondent no.20 cannot be called upon to defend and justify the proceedings conducted by and decision taken by the respondent lender banks declaring the account of company as fraud or to take any further steps required to defend such decision from the prospective of principles of natural justice.

6. Mr Amar Bhatt, learned advocate appearing for the Reserve Bank of India has submitted that it has limited role to play. So far as contention raised by the respondent lender banks is concerned, the same is misplaced and misconceived. The Master Directions 2021,

will not have any application to the transactions inasmuch as, such transactions would be governed under the provisions of Code of 2016 which, will have an overriding effect. It is submitted that if the fresh action is to be taken, it has to be by the respondent lender banks and not by the respondent no.20.

7. Heard the learned advocates appearing for the respective parties and considered the documents available on record.

8. The petitioners, as referred to hereinabove, have challenged the decision of the respondent lender banks taken in the meeting dated 29.09.2020 declaring the account of the company as a fraud. Contention is raised by the petitioners that while taking the decision, the petitioners have not been offered any opportunity to deal with the forensic audit report and/or the supplementary forensic audit report which otherwise, is a mandate issued by the Apex Court in the recent judgment in the case of *State Bank of India and Others v. Rajesh Agarwal and Others* (supra). Pertinently, except sharing the observations of the draft forensic audit report with the petitioners neither the copy of forensic audit report nor supplementary forensic audit report was provided to the petitioners. The said aspect is not disputed by the learned counsel appearing for the respondents and in particular the respondent lender banks and therefore, without entering into any other aspects, only on this limited ground, the captioned writ petition deserves to be allowed.

9. Notably, the Master Directions of 2016 on frauds and more particularly, Chapter VIII titled “Loan Frauds – New Framework” deals with the procedure to be followed while declaring the account as a fraud account. Clause 8.9.4 provides for decision to classify any standard account or NPA account as RFA or Fraud at the individual

level and the responsibility of the bank to report the RFA or Fraud status of the account on the CIRLC platform so that other banks are alerted. Clause 8.9.5 envisages completion of forensic audit within a stipulated period. It also provides that in case the decision is to classify the account as a fraud, the RFA status shall be changed to fraud in all banks and to report to Reserve Bank of India and on the CIRLC platform within a stipulated period.

10. Master Direction of 2016 on frauds, was subject matter of challenge before various High Courts on the ground that no opportunity of being heard is envisaged to the borrowers before classifying the account as fraudulent. The judgment rendered by the High Court of Telangana was subject matter of challenge before the Apex Court wherein, it was held that the principles of natural justice must be read into the provisions of Master Directions of 2016 on frauds. The issue before the Apex Court was as to whether the principles of natural justice should be read into Master Directions of 2016 on frauds. The Apex Court, held and observed that the principles of natural justice and more particularly, 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 has been held that classification of an account as fraud entails serious civil consequences for the borrower, and the directions must be construed reasonably by reading into them the requirement of observing the principles of natural justice. The Apex Court, therefore, in paragraph 81, held that audi alteram partem, therefore, entails that an entity against whom evidence is collected must: (i) be provided an opportunity to explain the evidence against it; (ii) be informed of the proposed action, and (iii) be allowed to represent why the proposed action should not be taken. It has also

been held and observed that mere participation of the borrower during the course of the preparation of a forensic audit report would not fulfil the requirements of natural justice. The decision to classify an account as fraud involves due application of mind to the facts and law by the lender banks. The lender banks, either individually or through a JLF, have to decide whether a borrower has breached the terms and conditions of a loan agreement, and based upon such determination the lender banks can seek appropriate remedies. It has also been held and observed that therefore, principles of natural justice demand that the borrowers must be served a notice, given an opportunity to explain the findings in the forensic audit report, and to represent before the account is classified as fraud under the Master Directions on Frauds. Paragraphs 81, 93 to 95 and 98 are reproduced hereinbelow for ready reference:

“81. Audi alteram partem, therefore, entails that an entity against whom evidence is collected must: (i) be provided an opportunity to explain the evidence against it; (ii) be informed of the proposed action, and (iii) be allowed to represent why the proposed action should not be taken. Hence, the mere participation of the borrower during the course of the preparation of a forensic audit report would not fulfil the requirements of natural justice. The decision to classify an account as fraud involves due application of mind to the facts and law by the lender banks. The lender banks, either individually or through a JLF, have to decide whether a borrower has breached the terms and conditions of a loan agreement, and based upon such determination the lender banks can seek appropriate remedies. Therefore, principles of natural justice demand that the borrowers must be served a notice, given an opportunity to explain the findings in the forensic audit report, and to represent before the account is classified as fraud under the Master Directions on Frauds.

93. It has been elucidated in the preceding paragraphs that the classification of a borrower's account as fraud in accordance with the procedure laid down in the Master Directions on Frauds entails significant civil consequences for the borrower. Since the Master Directions on Frauds do not expressly provide an opportunity of being heard to the borrower before

classifying an account as fraud, the rule of audi alteram partem has to be read into the provisions of the said directions to save them from the vice of arbitrariness.

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.

95. In light of the legal position noted above, we hold that the rule of audi alteram partem ought to be read in Clauses 8.9.4 and 8.9.5 of the Master Directions on Fraud. Consistent with the principles of natural justice, the lender banks should provide an opportunity to a borrower by furnishing a copy of the audit reports and allow the borrower a reasonable opportunity to submit a representation before classifying the account as fraud. A reasoned order has to be issued on the objections addressed by the borrower. On perusal of the facts, it is indubitable that the lender banks did not provide an opportunity of hearing to the borrowers before classifying their accounts as fraud. Therefore, the impugned decision to classify the borrower account as fraud is vitiated by the failure to observe the rule of audi alteram partem. In the present batch of appeals, this Court passed an ad interim order restraining the lender banks from taking any precipitate action against the borrowers for the time being. In pursuance of our aforesaid reasoning, we hold that the decision by the lender banks to classify the borrower accounts as fraud, is violative of the principles of natural justice. The banks would be at liberty to take fresh steps in accordance with this decision.

98. The conclusions are summarised below:

98.1. No opportunity of being heard is required before an FIR is lodged and registered.

98.2. Classification of an account as fraud not only results in reporting the crime to the investigating agencies, but also has other penal and civil consequences against the borrowers.

98.3. 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.

98.4. 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.

98.5. 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.

98.6. 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.

98.7. 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."

11. Clearly, rule of audi alteram partem has been read into clauses 8.9.4 and 8.9.5 of the Master Directions of 2016 on frauds. The Apex Court has also directed that consistent with the principles of natural justice, the lender banks should provide an opportunity to a borrower by furnishing a copy of the audit reports and allow the borrower a reasonable opportunity to submit a representation before classifying the account as fraud coupled with passing of a reasoned order on the objections addressed by the borrower.

12. Undisputedly, in the present case, no such steps have been taken by the respondent lender banks and therefore, on this limited ground of violation of principles of natural justice, the decision of the

respondent banks declaring the account of the company as fraud is hereby quashed and set aside. The matter is remitted and let the respondents concerned, after furnishing the copies of the forensic audit report and supplementary forensic audit report so also reasonable opportunity to the petitioners to submit the representation, complete the proceedings by passing order. The aforesaid exercise, shall be undertaken in conformity with the principles laid down by the Apex Court in the above referred judgment and within a period of six months from the date of the receipt of the copy of this order. This Court, has not expressed any opinion as regards criminal proceedings, if any.

13. In view of the above, petition stands partly allowed. No order as to costs.

RAVI P. PATEL

(SANGEETA K. VISHEN,J)