$~A-54

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ W.P.(C) 10138/2020 and CM Nos. 32290-32291/2020

M/S MODERN INSTRUMENTS PVT. LTD. & ANR...... Petitioners
Through Mr. Dayan Krishnan, Sr. Adv. with Ms. Priyadarshini Verma, Mr. Sanjeev Sheshadri and Ms. Aarohi Mikkilieni, Advs.

versus

RESERVE BANK OF INDIA & ORS. ..... Respondents
Through Mr. Vinod Gupta for R-2
Mr. Santosh Kumar Raut, Adv. for R-3

CORAM:
HON'BLE MR. JUSTICE JAYANT NATH

O R D E R

% **10.12.2020**

This hearing is conducted through Videoconferencing.

CM No. 32290/2020 (for interim relief) & W.P.(C) 10138/2020

1. In CM APPL. No. 32290/2020 seeking interim relief filed alongwith the petition, the petitioners had prayed as follows :-

> "a) Stay the effect and operation of the any action taken, contemplated or threatened of the Respondent No. 2 of categorizing the account of the Petitioner No. 1 company as a "Fraud Account", till the pendency of the present petition;"

2. By the present application, the petitioners contend that they have learnt from a third party that the account of the petitioner No.1 with respondent No. 2/Bank has been classified as 'fraud' under circular dated 01.07.2016 issued by respondent No. 1/RBI, which circular contains

"Master Directions on Frauds —Classification and Reporting by commercial banks and select FIs".

3. Earlier the petitioners had approached this court by way of writ petition being W.P.(C). 5780/2020 claiming relief against the proceedings taken by respondent No. 2/Bank to declare the petitioners as 'wilful defaulters' in accordance with the RBI's Master Circular dated 01.07.2015. In this petition by order dated 21.08.2020 stay was granted for any steps to be taken pursuant to the impugned communication dated 31.12.2019 made by respondent No. 2 declaring the petitioners as 'wilful defaulters'.

4. Mr.Dayan Krishnan, learned Senior Counsel appearing for the petitioners states that while the process for re-considering the issue of declaring the petitioners as 'wilful defaulters' is still going on, respondent No.2/Bank has proceeded to declare the petitioners' accounts as 'fraud' under the RBI Circular dated 01.07.2016.

5. Mr. Krishnan submits that RBI's Circular dated 01.07.2016 aforesaid deserves to be quashed *inter alia* for the reason that it provides a mechanism whereby an account can be declared 'fraud' without following the principles of natural justice; and furthermore, in the facts of this case, respondent No. 2 could not have declared the petitioners' account as 'fraud' while the process for reconsidering the issue of petitioners being declared wilful defaulters was still underway.

6. The contentions and counter-contentions notwithstanding, in my *prima facie* view there clearly appears to be an issue as RBI's Master Directions dated 01.07.2016 relating to classification and reporting of 'fraud' does not contain any provision for issuance of show-cause notice or affording a hearing to the affected party, even though a decision by a bank,

whether taken individually or collectively with other banks, to classify an account as 'fraud' is a significant decision having serious consequences for the account holder.

7. It is noteworthy that while the RBI circular dealing with 'wilful defaulters' provides a mechanism whereby a hearing is given to the affected party, no opportunity of hearing appears to be available in the circular that deals with declaring an account as 'fraud', which latter is a much more serious matter.

8. Issue notice.

9. Mr. Vinod Gupta, learned counsel for respondent No. 2/Bank appears on an advance copy and accepts notice.

10. He contends that the matter of declaring an entity as 'wilful defaulter' is different and distinct from that of declaring an account as 'fraud', the two matters are covered by different master circulars; and the mechanisms therefor cannot be compared.

11. To me it *prima facie* appears that declaring an account as 'fraud' would arise in a case of egregious default on the part of an account holder, something more than the account holder being a 'wilful defaulter'. For an account to be declared as 'fraud' must entail an element of *criminality* on the part of the account holder, which ought to be inferred *only* on the basis of some substantial material which must be put to the errant account holder; and after considering any explanation such account holder has to offer; and not unilaterally by a stroke of the pen.

12. In the circumstances, without prejudice to the rights and contentions of the parties, all of which are kept open, it is directed that respondent No. 2/bank shall *not* take any further steps or actions prejudicial to the

petitioners based upon the petitioners' account being declared 'fraud' until the next date of hearing.

13. Let notice be issued to respondent No.1/RBI by all permissible modes, returnable for 21.12.2020.

14. Let pleadings in the matter be completed. Reply be also filed within four weeks. Rejoinder thereto if any, be filed within three weeks thereafter.

DECEMBER 10, 2020 **JAYANT NATH, J**

AD/rb