

**(2014) 07 AHC CK 0291**  
**In the Allahabad High Court**  
**Case No : C.M.W.P. No. 36445 of 2014**

Ashok Kumar and Co.

APPELLANT

Vs

Reserve Bank of India

RESPONDENT

**Date of Decision :** 18-07-2014

**Acts Referred:**

Banking Regulation Act, 1949 — Section 35A, 45(1)

Constitution of India, 1950 — Article 226

Uttar Pradesh Co-operative Societies Act, 1965 — Section 56(ccv)

**Citation :** (2014) 106 ALR 471 : (2014) 6 AWC 5843 : (2015) 2 BC 177 : (2014) 3 UPLBEC 2237

**Hon'ble Judges :** Dr. Dhananjaya Yeshwant Chandrachud, C.J.; Dilip Gupta, J

**Bench :** Division Bench

**Advocate :** Sidharth and Shashi Nandan, Advocate for the Appellant; Rohit Agarwal, Advocate for the Respondent

## Judgement

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Dr. Dhananjaya Yeshwant Chandrachud, C.J. and Dilip Gupta, J.—The petition under Article 226 of the Constitution has been filed in order to assail the legality of an order dated 4 June, 2014 passed by the Reserve Bank of India under section 35-A of the Banking Regulation Act, 1949. A challenge has also been made to a subsequent order that was passed by the Executive Director of the Bank on 1 July, 2014 on the objections submitted by the Bank. In consequence, a mandamus is sought to the effect that the petitioner should be permitted to withdraw the money deposited in its current account and to undertake normal banking activities. The seventh respondent, Indian Mercantile Co-operative Bank Limited, is a primary Urban Co-operative Society registered under the U.P. Co-operative Societies Act, 1965 and has been granted a banking licence by the Reserve Bank. It is stated that the seventh respondent is a primary co-operative bank within the meaning of section 56(ccv) of the Act. The petitioner had opened a current account in the bank through which its business transactions were conducted.

2. On 4 June 2014, the Reserve Bank issued directions in exercise of the powers conferred by section 35-A of the Act. The directions prohibit the seventh respondent, without the prior approval in writing of the Reserve Bank, from granting or renewing any loans or advances, making any investment, incurring any liability including borrowal of funds and acceptance of fresh deposits and disbursement of any payment in discharge of its liabilities, obligations or otherwise. This is subject to the condition that a sum not exceeding one thousand rupees, out of the total balance in every savings account or current account or any other deposit account by whatever name called, may be allowed to be withdrawn by a depositor provided that wherever a depositor has a liability to the bank in any manner, the amount may be adjusted first to the relevant borrowal account. Certain other exceptions have been stipulated which are not material for the purpose of these proceedings.

3. On 16 June, 2014, a circular has been issued by the Reserve Bank, providing for certain exceptional situations in which withdrawal of deposits would be permitted, subject to the recommendations of the Screening Committee and the approval of the Administrator for onwards submission to the Reserve Bank. The guidelines which have been framed in that regard provide as follows:

"1. A depositor is permitted to withdraw not more than Rs. 1.00 lakh on medical grounds and Rs. 0.50 lakh for other purposes i.e., education of self/children, marriage of self/children/brother/sister and livelihood.

2. A depositor will submit an application for withdrawal under hardship (Annex. 2) to the Screening Committee of the Urban Co-operative Bank headed by the Administrator/Board and comprising Chief Executive Officer/General Manager/representatives of Depositors forum and Staff Union. The applications with recommendations of the Screening Committee will be forwarded to UBD, Lucknow.

3. In case of term deposits, premature payment will not be allowed.

4. The Screening Committee may ensure that the requisite documents are in place; for example--

(i) In case of marriage-marriage card in original/prepaid booking receipt of marriage hall etc., relationship proof in case of marriage of children/brother/sister.

(ii) On medical grounds.--If the treatment has occurred then the medical bills/receipts. If the treatment is yet to take place, then medical estimates certificate by the hospital/doctor etc.

(iii) In case of education - Photocopies of receipts of fees paid, relationship proof, admission proof etc.

4. The direction that was issued by the Reserve Bank under section 35-A was challenged before a Division Bench of this Court at Lucknow in a batch of

petitions. By an order dated 19 June, 2014, the Division Bench permitted the depositors to approach the Reserve Bank for withdrawal of their deposits in accordance with the guideline dated 16 June, 2014. In the meantime, the Reserve Bank was directed to decide objections to the direction under section 35-A and to pass a reasoned and speaking order thereon within a period of ten days.

5. In pursuance of the order passed by the Division Bench, the Executive Director of the bank has issued the impugned order dated 1 July, 2014. The order specifically refers to the financial position of the seventh respondent which led to the issuance of the direction under section 35-A. The order states that an inspection of the bank was carried out with reference to its financial position as on 31 March 2007 which revealed that the bank had violated the guidelines issued by the Reserve Bank on unsecured advances and did not report correctly the high value cash transactions. Subsequently, a scrutiny in April 2008 revealed major irregularities in the advances portfolio at the main branch of the bank committed by the management in a fraudulent manner. It was also found that sanctions were granted to fictitious and unsecured advances which were not in adherence to KYC guidelines. The inspection conducted with reference to the financial position as on 31 March, 2008 revealed that the bank had not taken effective steps to comply with the instructions of the Reserve Bank. An inspection with reference to the financial position as on 31 March 2010 revealed understatement of deposit liabilities to the extent of Rs. 64 crores. It was observed that the bank had resorted to showing fictitious loans in its books to cover up the loss of Rs. 38.50 crores in unauthorised trading in the stock market in 2001-02. The impugned order also reveals the position following the inspection which was conducted with reference to the financial position as on 31 March, 2011 and 31 March, 2012. The position of the bank indicated in the impugned order is as follows:

"During the inspections conducted with reference to the financial positions as on March 31, 2011 and March 31, 2012, the bank's claim to have received funds of Rs. 64.00 crore in the month of August 2010 to adjust the fraudulent entries passed by the bank was looked into. It was found that Rs. 34.15 crores out of the Rs. 64.00 crore so claimed to have been received was in the form of fresh debits in certain borrowal accounts related to the entities associated with promoters/directors and the remaining amount was received by cash/funds transfer from commercial banks. As the bank had not submitted satisfactory evidence of origin of funds stated to have been received, it was treated as sundry deposits. The bank passed book entries on November 6, 2011 with value date as on March 31, 2011 and showed a loss of Rs. 64.00 crore in its books. Further out of the Rs. 64.00 crore shown as receipt, the bank had transferred Rs. 50.00 crore to various loan accounts. The balance of Rs. 14.00 crore and subsequent receipt of Rs. 8.00 crore aggregating to Rs. 22.00 crore was converted as share capital. The bank however could not explain the actual source of the funds of the above Rs. 22.00 crore received from four accounts mainly promoter/ex-director related concerns."

6. Similarly, an inspection as on 31 March 2013 revealed the following the following position of the bank:-

"The inspection of the bank as on March 31, 2013 revealed further increase of capital of Rs. 30.48 crore out of which a sum of Rs. 28.50 crore from 8 concerns related to promoters/ex-directors was routed either through the loan accounts or were received through clearing/RTGS in the bank's current account maintained for dealing in securities. The real source of contribution towards capital subscription from these accounts could not be ascertained. Further, the bank could not give satisfactory explanation for the same."

7. The conclusion which has been drawn in the report of the Executive Director finally suggests the following:

"... As a result, the Capital to Risk-weighted Assets Ratio of the bank was reassessed at (-) 46.88% against the regulatory requirement of 9%, the net worth was reassessed at (-) Rs. 62.10 crore, the latter implying that not only were the entire capital and reserves used up but also 21.14% of the deposits have been eroded. The accumulated loss of Rs. 75.80 crore in the balance sheet of the bank after booking the fraud of Rs. 64.00 crore is a matter of serious concern. The bank has not yet filed FIR against the officials responsible for the serious irregularities despite repeated instructions from RBI in the matter."

8. The impugned order, thus, has come to the conclusion that the irregularities committed by the bank for twelve years without any corrective action had placed the interest of the depositors in jeopardy and the major lapses have been sought to be covered up through doubtful funds transfers to artificially shore up capital which was a matter of regulatory concern and required major supervisory action. The erosion in deposits stood at Rs. 21.14% and, hence, it was considered necessary to protect the overall interest of the depositors by placing the bank under directions that were issued under section 35-A.

9. Section 35-A of the Banking Regulation Act provides as follows:

"35-A. Power of the Reserve Bank to give directions.--(1) Where the Reserve Bank is satisfied that--

(a) in the public interest; or

(aa) in the interest of banking policy; or

(b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or

(c) to secure the proper management of any banking company generally; it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

(2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any directions issued under sub-section (1) and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect."

10. As far back in 1962, a Constitution Bench of the Supreme Court in *Joseph Kuruvilla Vellukunnel Vs. The Reserve Bank of India and Others*, , dealt with the rationale for the wide powers conferred upon the Reserve Bank to regulate banking companies. Justice M. Hidayatullah (as the learned Chief Justice then was) held thus:

"...Ex facie, the banking companies must be regulated somewhat differently, and the interests of the depositors must be paramount and the winding up of such companies depends upon other considerations, chief among which is the desire to pay off the creditors as far as possible in full or at least equitably. The action is thus dictated not from any abstract consideration of a long-range view of the future ability of a bank to pay its creditors but its ability to pay them at any given time. In this connection, the Reserve Bank has been given by the Banking Companies Act the power and invested with the duty of watching the affairs of every banking company with a view to ensuring the safety of the depositors' money. There is thus, at the very start, a reasonable classification, which is also a very just and practical classification, to achieve the avowed purpose."

The Supreme Court observed as follows:

"...The first is that the whole intent and purpose of that Act is to secure the interests of the depositors. The second is that the Reserve Bank is the instrumentality by which this intent is to be achieved. The Act, at every turn, makes the Reserve Bank the authority to sanction, permit, certify, inspect, report, advise, control, direct, license and prohibit. There is hardly any provision where the Reserve Bank's judgment is not made final vis-a-vis a banking company except rarely where an appeal to the Central Government can lie. No useful purpose will be served in referring to these sections in detail."

11. This view was reiterated in *Rakesh Ranjan Verma and others Vs. State of Biha and others*, . The Supreme Court observed as follows:

"Before examining the scope and effect of the impugned paragraphs 6 and 12 of the directions of 1987, it is also important to note that Reserve Bank of India which is bankers bank is a creature of Statute. It had large contingent of expert advice relating to matters affecting the economy of the entire country and nobody can doubt the bona fides of the Reserve Bank in issuing the impugned directions of 1987. The Reserve Bank plays an important role in the economy and financial affairs of India and one of its important functions is to regulate the banking system in the country. It is the duty of the Reserve Bank to safeguard the economy and financial stability of the country...."

12. In *Ganesh Bank, Kurundwad Ltd. and Others Vs. The Union of India (UOI)*

and Others, , the Supreme Court held as follows:

"The ultimate question is whether the inference drawn by the RBI is a possible inference or is something which can be said to be a perverse one. Even if two views are possible since the regulating body has arrived at a conclusion on the basis of the facts and figures before it, and it has pointed out that it has been warning the appellant Bank for the last over 3 years, it will not be proper for the Courts to substitute their judgment for that of RBI. In the circumstances, it cannot hold that the decision of RBI to impose the moratorium was unjustified or against the provisions of section 45(1) or such that one can call it a perverse one and interfere with it. The RBI is an expert body to regulate the banking activities..."

13. The same principle was enunciated in a judgment of a Division Bench of the Delhi High Court in *Bari Doab Bank Ltd. Vs. Union of India and others*, :

"In this behalf, it must be stated again that the Reserve Bank of India is an expert body and it supervises and regulates the banking services in the entire country. The unique position of the Reserve Bank has been recognised by the Supreme Court and the High Courts in several judgments. It is not necessary to refer to the passages in those judgments once again as the same are set out in the judgment of the learned Single judge. Nor do we propose to extract the grounds contained in the moratorium applications filed under section 45(1) of the Act. We are of the view that inasmuch as the said applications give ample details of the financial position of the Punjab Co-operative Bank and of the Bari Doab Bank and say that they are being run as family concerns and further that so far as Bari Doab Bank is concerned, it is a small bank which, in the interests of the bank, its depositors and the policy of the Reserve Bank, be merged with a bigger bank - it is not for us to go into the correctness of the expert opinion of the bank."

14. The Reserve Bank, it is well settled, is an expert statutory body which is vested with control over the banking system. This power is vested in the Reserve Bank of India to foster public interest and to ensure a suitable financial and monetary system. It is well settled that in matters governed by expert determination, the jurisdiction of the Court to interfere in the exercise of the power of judicial review is extremely limited. The Court may interfere where the action which has been taken is wholly extraneous to the object and purpose underlying the conferment of the power or where ex-facie the decision is found to be perverse and contrary to binding statutory norms.

15. The order which has been passed by the Executive Director in the present case, following the objections which were received from the bank, did not consider any matter which was not relevant and germane to the exercise of power under section 35-A. In the exercise of the writ jurisdiction, it would not be open to the Court to substitute this conclusion which has been drawn by the Reserve Bank as an expert statutory body. The Reserve Bank has acted in the interest of the depositors since it is evident that there was a serious financial

crisis in respect of the affairs of the bank.

16. Hence, considering the matter from all perspectives, it would not be possible for the Court to issue a direction to the effect that the deposit which has been made by one depositor should be allowed to be withdrawn. Allowing the operation of the current account of the petitioner in the manner as sought, would be completely destructive of the interest of a large body of depositors. The grant of such a relief would not be permissible. Hence, no case for interference is made out.

17. The writ petition is, accordingly, dismissed. There shall be no order as to costs. The Registrar General is directed to remit a copy of this order to the Senior Registrar of the Lucknow Bench to place the same on the file of Misc. Bench No. 4861 of 2014 (Indian Mercantile Co-operative Bank Ltd. Lucknow v. Reserve Bank of India and others), pending before the Lucknow Bench.