(SUPREME COURT OF INDIA)

Pramod Malhotra

Vs

Union of India

HON'BLE JUSTICE S. N. VARIAVA AND HON'BLE JUSTICE H. K. SEMA

26/02/2004

Writ Petition (C) No. 119 of 2001

JUDGMENT

S. N. VARIAVA, J.

S.N. VARIAVA, J.- This Writ Petition has been filed challenging a scheme framed by the Reserve Bank of India (for short RBI). Mr. Lalit very fairly stated at the beginning that he is not challenging the scheme and that the only prayer he is pressing is Prayer (g), which reads as follows :

"(g) issue a writ or order in the nature of mandamus directing the Respondents to repay the petitioners and other fixed deposit holders of the erstwhile Sikkim Bank Ltd. in full, including the principal along wilh the contract rate of interest (14% p.a.)-" *

2. At this stage, the facts may be briefly set out:

On 2nd August, 1985 Sikkim Banking Overseas Corporation Limited got itself registered as a Company in Sikkim. On 22nd October, 1987 its name was changed to Sikkim Banking Limited (for short SBL). On 11th December, 1987 the Banking Regulation Act (for short the Act) became applicable to Sikkim. Section 22 of the Act reads as follows :

"Licensing of Banking Companies.-(1) Save as hereinafter provided, no company shall carry on banking business in India unless it holds a licence issued in that behalf by the Reserve Bank and any

such licence may be issued subject to such conditions as the Reserve Bank may think fit to impose.

(2) Every banking company in existence on the commencement of this Act, before the expiry of six months from such commencement, and every other company before commencing banking business in India, shall apply in writing to the Reserve Bank for a licence under this section :

Provided that in the case of a banking company in existence on the commencement of this Act, nothing in sub-section (1) shall be deemed to prohibit the company from carrying on banking business until it is granted a licence in pursuance of this section or is by notice in wilting informed by the Reserve Bank that a licence cannot be granted to it:

Provided further that the Reserve Bank shall not give a notice as aforesaid to a banking company in existence on the commencement of this Act before the expiry of the three years referred to in sub-section (1) of section 11 or of such further period as the Reserve Bank may under that sub-section think fit to allow.

(3) Before granting any licence under this section, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the following conditions are fulfilled, namely :-

(a) that the company is or will be in a position to pay its present or future depositors in full as their claims accrue;

(b) that the affairs of the company are not being, or are not likely to be, conducted in a manner detrimental to the interests of its present or future depositors;

(c) that the general character of the proposed management of the company will not be prejudicial to the public interest or the interest of its depositors;

(d) that the company has adequate capital structure and earning prospects;

(e) that the public interest will be served by the grant of a licence to the company to carry on banking business in India;

(f) that having regard to the banking facilities available in the proposed principal area of operations of the company, the potential scope for expansion of banks already in existence in the area and other relevant factors the grant of the licence would not be prejudicial to the operation and consolidation of the banking system consistent with monetary stability and economic growth;

(g) any other condition, the fulfillment of which would, in the opinion of the Reserve Bank, be necessary to ensure that the carrying on of banking business in India by the company will not be prejudicial to the public interest or the interests of the depositors.

(3A) Before granting any license under this section to a company incorporated outside India, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the conditions specified in sub-section (3) are fulfilled and that the carrying on of banking business by such company in India will be in the public interest and that the Government or law of the country in which it is incorporated does not discriminate in any way against banking companies

registered in India and that the company complies with all the provisions of this Act applicable to banking companies incorporated outside India.

(4) The Reserve Bank may cancel a licence granted to a banking company under this section-

(i) if the company ceases to carry on banking business in India; or

(it) if the company at any time fails to comply with any of the conditions imposed upon it under sub-section (1); or

(HI) if at any time, any of the conditions referred to in sub-section (3) and sub-section (3A) is not fulfilled :

Provided that before cancelling a licence under clause (ii) or clause (Hi) of this sub-section on the ground that the banking company has failed to comply with or has failed to fulfill any of the conditions referred to therein, the Reserve Bank, unless it is of opinion that the delay will be prejudicial to the interest of the company's depositors or the public, shall grant to the company on such terms as it may specify, an opportunity of taking the necessary steps for complying with or fulfilling such a condition.

(5) Any banking company aggrieved by the decision of the Reserve Bank cancelling a licence under this section may, within thirty days from the date on which such decision is communicated to it, appeal to the Central Government.

(6) The decision of the Central Government where an appeal has been preferred to it under sub-section (5) or of the Reserve Bank where no such appeal has been preferred shall be final." *

3. SBL applied for a license. It appears that RBI did not issue any notice informing SBL that the license could not be granted.

4. Therefore even though the license was not granted SBL continued to carry on banking business by virtue of the proviso of sub-clause (2).

5. In 1996 RBI pointed out certain operational deficiencies in the working of SBL. SBL was called upon to cure those deficiencies before a license could be issued to it. Thereafter RBI advised SBL to raise additional capital to the extent of Rs. 50 crores by way of a rights preferential issue. RBI made it clear that it would consider issue of a license to SBL only after the capita] was so raised. SBL managed to raise an extent of Rs. 15.18 crores, out of which approximately Rs. 5.80 crores was by means of diversion of SBL's own funds.

6. In February- March 1997 RBI conducted financial inspection of SBL and found several shortcomings and deficiencies in its functioning. Yet on

25th June, 1997 RBI authorised SBL to open a branch in Delhi at the Metropolitan Centre, 37 DLF, Kirti Nagar, New Delhi. All the Petitioners are depositors/co-depositors in this branch of SBL. It appears that they deposited pursuant to advertisements issued by SBL offering a higher rate of

interest than other banks.

7. A special scrutiny conducted in 1998 RBI found that non-performing assets or bad debts were Rs. 58.26 crores, whereas provision was for only Rs. 1.52 crores. This meant that SBL had incurred a net loss of Rs. 56.22 crores. Ultimately by a letter dated 15th December, 1998 RBI issued a show-cause notice to the Managing Director Shri A.M. Mustafi under section 36AA(2) and pending reply prohibited him from acting as the Managing Director. In January 1999 RBI removed Shri A.M. Mustafi and appointed three additional Directors on SBL's Board. Thereafter special audit was carried out. As a result of the audit the Government of India was informed about the poor state of affairs in SBL. The Government of India was informed that the funds had been siphoned out to the tune of Rs. 57.50 crores.

8. On 8th March, 1999, on the advise of RBI, the Government of India passed an Order of Moratorium under section 45(2) of the Act, SBL filed a Writ Petition in the High Court of Sikkim challenging the Order of Moratorium. However, the Petition was dismissed on 2nd September, 1999. The Special Leave Petition filed against the Order has also been dismissed.

9. On 21st December, 1999 the Government of India issued an Order notifying a Scheme of Amalgamation under section 45(7) of the Act. By this scheme SBL was amalgamated with the Union Bank of India (for short UBI). Under the scheme all the depositors were to be paid on pro rota basis. It is an admitted position that the depositors are only getting 9.037% of their deposits and they are required to surrender their fixed deposits receipts in return.

10. The Petitioners filed a Writ Petition in the Delhi High Court challenging the scheme. However, pursuant to an Order of this Court dated 26th April, 2000, wherein it was directed that all matters connected with the amalgamation of SBL with UBI must be filed only in this Court that Petition was withdrawn and this Petition has been filed.

11. Mr. Lalit submitted that under the Act RBI has got wide powers to control banking companies. He submitted that RBI is to ensure that the affairs of banking companies are not being or are not likely to be conducted in a manner detrimental to the interest of the depositors. He submitted that RBI had not issued a license to SBL because it found deficiencies in its working and yet on 25th June, 1997 it permitted SBL to open a branch in Delhi. He referred to section 23 of the Act whereby no banking company can open a new place of business without prior permission of RBI. He pointed out that before granting such permission RBI must be satisfied about the financial condition and history of the company, the general character of its management, the adequacy of its capital structure and earning prospects. He submitted that every banking company has compulsory to display the license issued by RBI at a prominent place. He submitted that the whole purpose is that the public would know whether to deal with a particular bank or not. He submitted that if a licence is granted by RBI then the public would presume that the financial condition of the company and the general character of its management are good and that the company had an adequate capital structure and earning prospects. He submitted that in this case RBI was already aware, before it granted permission to open a branch, that SBL had not been able to raise the sum of Rs. 50 crores as directed by RBI; that it could raise its capital only to the extent of Rs. 15.18 crores of which Rs. 5.80 crores was by siphoning of the bank's own funds; that there were several irregularities in its functioning and that it had advised SBL to rectify its irregularities. He submitted that yet RBI granted the license to open a branch thereby enabling SBL to dupe innocent depositors. He submitted that even though RBI became aware by 1998 that non-performing assets were to the tune

of Rs. 58.26 crores and that there was a short provision of Rs. 55.72 crores RBI allowed SBL to issue advertisements seeking deposits offering high rate of interest and did not warn the public about the poor financial condition of SBL.

Mr. Lalit relied upon the case of Union of India v. United India Insurance Co. Ltd. 5. This was a case where a bus, whilst crossing a unmanned railway crossing, was hit by a train. As a result thereof 40 passengers and the driver were killed - and many other passengers were injured. A large number of claims were filed before the Motor Accidents Claims Tribunal. The Tribunal in some of those cases held that the driver of the bus was negligent and passed awards against the owner of the bus and the Insurance Company. The Tribunal dismissed the claims against the Railways on the ground that there was no negligence on the part of the driver of the railway engine or on the part of the Railway Administration. On Appeals, the High Court held that the Railways were also liable.

12. The Union of India then filed Appeals to this Court. This Court framed the following questions for consideration :

"(1) What are the common law duties of a motor vehicle driver at a railway level-crossing? Whether, on facts the bus driver was negligent ?

(2) Whether, under the 'doctrine of imputation' the negligence of the driver in which the passengers traveled could be imputed to the passengers by the Railways as part of the Defence for the purpose of raising a plea of contributory negligence of the passengers ?

(3) Whether under the law of torts the claimants in rail-motor collisions can claim that the obligations of the Railway under the statute as well as under common law will run concurrently? What are the common law duties of the Railways at level-crossings and whether the Railway is bound to take cognizance of the increase in the volume of traffic and ought to have installed gates and kept a watchman at the level-crossing ?

(4) Whether a public authority upon whom powers are conferred by statute to exercise discretion for benefit of the public can be said to be under a duty of care so that omission to exercise that power could be treated as negligence at common law giving a right to compensation? If not, whether there are any exceptions to the rule that a statutory 'may' can never give rise to a common law 'ought? What is the effect of the omission of the Railways to exercise power under section 13(c) and (d) ?

(5) Whether the Motor Accidents Claims Tribunal has jurisdiction under section 110(1) of the Motor Vehicle Act, 1939 read with section HOB thereof [corresponding to sections 165 and 68(1) against the Railway Administration when a motor vehicle is hit by a railway train and whether the Tribunal can pass an award under section HOB against the Railways also, in addition to an award against the owner of the vehicle, driver and the insurer ?" *

13. For our purposes questions 3 and 4 above are relevant. Whilst considering these questions it was noticed that in India, unlike as in England, no duties were directly imposed on the Railway Administration to erect gates or employ watchmen etc. at level-crossings if the railway line was cutting across a public road. It was noticed that the only provision was section 13 of the Railways Act which reads as follows :

"13. Fences, screens, gates and bars.-The Central Government may require that, within a time to be specified in the requisition or within such further time as it may appoint in this behalf, -

(a) boundary-marks or fences be provided or renewed by a railway administration for a railway or any part thereof and for roads constructed in connection therewith;

(b) any works in the nature of a screen near to or adjoining the side of any public road constructed before the making of a railway be provided or renewed by a railway administration for the purpose of preventing danger to passengers on the road by reason of horses or other animals being frightened by the sight or noise of the rolling-stock moving on the railway;

(c) suitable gates, chains, bars, stiles or handrails be erected or renewed by a railway administration at places where a railway crosses a public road on the level;

(d) persons be employed by a railway administration to open and shut such gates, chains or bars." *

This Court held that in view of this provision there was no direct obligation on the Railway Administration and there was no statutory duty of the Railway Administration unless a requisition was made by the Government. It was held that the above anomaly has naturally compelled the Courts to fall back upon the common law duties resting on the Railways which would impose special responsibilities on the Railways to keep accidents at the minimum. It was held that these common law duties were enforceable concurrently with the statutory duties of the Union under section 13 or independently of it. This Court then went on to consider what were the common law duties of Railways at level-crossings and held that there was a duty to take care to see that accidents did not occur. This Court therefore confirmed the findings of the High Court that the Railways must be deemed to be negligent in not converting the unmanned level-crossings into manned crossings. This Court then went on to consider whether omission to perform statutory duties can or cannot give rise to action in private law and if they cannot, ordinarily, whether there are any exceptions. This Court strongly relied upon the case of Anns v. Merlon London Borough 1977 Indlaw HL 16. In this case the local authority did not properly scrutinize building plans, which resulted in cracking of walls. The local authority was held liable for the loss which resulted from their failure to perform their statutory duties. At this stage itself it must be mentioned that in the case of Murphy v. Brewtwood District Council 1989 Indlaw CA 83, it has been held that the principle laid down in Anns 'case (supra) cannot be applied to economic losses. Based upon the principles laid down in Anns'case (supra) this Court held that two conditions must be proved for passing a duty of care on the exercise of statutory power, viz., first that it would have been irrational not to have exercised the power so that there was a public duty to act and secondly that the policy of the statute must have been to require compensation to be paid to persons who would suffer damages because the power conferred was not exercised at all or not exercised when it was generally expected to be exercised. This Court then held that these two conditions were fulfilled inasmuch as section 13 required the Central Government to send a requisition to Railways to build suitable gates, chain, bars, walls erected by the Railway Administration. This Court held that it was irrational not to have exercised the power as there was a public duty to do so. This Court then went on to hold that section 13 impliedly required compensation to be paid to the persons who would suffer damages because the powers was not exercised when it should have been exercised.

14. Strongly relying upon this case, Mr. Lalit submitted that the various provisions of the Act cast a duty upon RBI to properly monitor Banking Companies and to safeguard the interest of the depositors. He submitted that one of the parameters, whilst considering when to grant license, is to check whether all deposits would be returned in full. He submitted that even though for 9 long years RBI had not issued a license to SBL because it found irregularities in its functioning it still allowed SBL to open a branch by granting a license under section 23. He submitted that this was done even when RBI had known from 1996 onwards that there were 'deficiencies and irregularities in the functioning of SBL. He submitted that even though RBI had called upon SBL to raise its share capital and SBL had failed to do so, the license was issued. He submitted that in this case both the conditions, namely, the statutory duty to act and irnpliedly the requirement to pay compensation to persons who suffer damages by virtue of non-exercise of the power, were present. He submitted that RBI must return all the deposits in full.

15. Mr. Lalit also relied upon the case of Nilabati Beherav. State of Orissa . He submitted that it has been held in this case that the award of compensation in a proceeding under Article 32 or Article 226 is a remedy available in public law, based on strict liability for contravention of fundamental rights to which the principle of sovereign immunity did not apply, even though it may be available as a Defence in private law in an action based on tort.

Mr. Lalit fairly pointed out the case of Sutherland Shire Council v. Heyman [1985] 60 Australian LR 1. In this case the local authority, whose duty was to inspect buildings was sought to be sued when a house was damaged due to inadequate foundation for the same. The High Court of Australia did not accept the principles in Anns'case (supra). However, Mr. Lalit submitted that even in this case it has been held that the public authority may be subject to a common law duty of care when it. exercises a statutory power or performs a statutory duty.

Mr. Lalit also relied upon the case of Ramana Dayaram Shetty v. International Airport Authority of India In this case the question was regarding grant of license to run a restaurant-cwm-snack bar at the International Airport at Bombay. The decision of Airport Authority was challenged and the Court was considering what were the constitutional obligations on the part of the State when it takes any action in its statutory or executive authority. It is in this context that it was held that an executive authority must be rigorously held to standards by which it professed its actions to be judged and it must scrupulously observe those standards on pain of invalidation of an act in violation of them.

Mr. Lalit submitted that, in this case, all persons who deposited with the Delhi Branch of SBL, relied on the license issued by RBI. He submitted that they presumed that such a license had been issued only because SBL functioning is sound and its management good. Mr. Lalit submitted that on the above principles this Court must direct RBI to pay all the depositors in full.

16. Mr. Sorabjee submitted, and in our view correctly, that the Indian cases relied upon by Mr. Lalit are all cases which relate to infringement of life and liberty under Article 21 ie., where a person has been injured or killed. It is in those type of cases that the above mentioned principles have been applied in India. Mr. Sorabjee pointed that Mr. Lalit was not able to show any case where these principles have been applied to financial transactions undertaken by individuals with open eyes in the hope of making larger profits. He submitted that except for a few stray averments in the Petition there was no averment that by issuing license RBI represented that SBL was sound and creditworthy.

Mr. Sorabjee relied upon the case of Yuen Kunyeu v. A-G of Hong Kong [1987J 2 All England LR 705. In this case the Commissioner of Deposit-taking Companies in Hong Kong had regulatory functions in relation to deposit-taking businesses in Hong Kong by virtue of the Deposit-taking Companies Ordinance, 1976. The Commissioner was sought to be made liable for losses incurred by depositors in a Deposit Taking Company which went into liquidation. It was claimed that that Company had been run fraudulently, speculatively and to the detriment of depositors and that even though the Commissioner had reasons to suspect that the Company was being so run he had failed to take any action to protect the depositors. It was claimed that the depositors had relied upon the fact of registration as indicating that the Company was a fit and proper body and that the Company was under the supervision of the Commissioner. It was claimed that the Commissioner knew or ought to have known that the affairs of the Company were being conducted fraudulently, speculatively and to the detriment of the depositors and that he should never have registered the Company or should have revoked its registration. Thus the facts of this case are almost identical to the present case and the submissions are also the same. The High Court of Hong Kong struck out the claim on the basis that it disclosed no cause of action. The Privy Council held that the above mentioned factors were not sufficient to establish duty of care in negligence. It was also held that there was no close and direct relationship or proximity between the parties enough to give rise to such a duty. It was held that rarely would the further question whether public policy required liability for breach of such a duty would be considered. It was held that even though it was reasonably foreseeable that if an uncredit worthy company were to be registered or allowed to remain on the register persons who deposited money with it would be at risk of losing their money, mere for see ability of that harm did not by itself create sufficient proximity between the Commissioner and would be depositors for a duty of care to arise. It was held that the Commissioner had no control over the day to day management of the Company and that the Ordinance did not give far reaching and stringent supervisory powers so as to warrant an assumption that all registered companies were sound and fully creditworthy. It was held that in any case of the Commissioner cannot reasonably be expected to know that would be depositors would rely on the fact of registration as a guarantee of the soundness of the Company.

Mr. Sorabjee relied upon the case of Davis v. Radcliffe [1990] 2 All England LR 536. In this case the Plaintiff had deposited 7, 000 with a Bank in Isle of Man. That Bank was licensed, under the Banking Act, for a number of years. The license was revoked only in June 1982. In August 1982 the bank collapsed with a deficit in excess of 40 million. An action was brought against the Isle of Man Finance Board and the Treasurer claiming damages for loss of amounts deposited with the Bank on the allegation that it was caused by the negligence of the defendants in carrying out their duties under the Banking Act. The alleged duties were the duties in issuing a license and/or the duty to refuse or to revoke a license or to suspend or discontinue the business of a bank and to inspect the books and documents of a bank. It was claim ed that the Board and the Treasurer owed their depositors a duty to carry out their statutory functions in relation to licensing and supervision of the Bank in such a manner that the depositors' funds were safe and properly managed. Thus, the facts of this case were also identical to the facts of the present case. Such a claim was not accepted. It was held that relationship between the Plaintiffs and Defendants was not such that it would be just and reasonable to impose the liability in negligence for the loss suffered by the Plaintiffs. It was held that the Board and the Treasurer were exercising typical functions of modern Government in the general public interest which included balancing of competing considerations. It was held that the Defendants did not possess sufficient control over the management of the Bank to warrant imposition of liability. The principles laid down in Anns' case (supra) were held not applicable to

financial transactions.

Mr. Sorabjee also relied upon the case of Three Rivers DC v. Bank of England[200Cf] 3 All England LR 1 and in [2001] 2 All England LR 513. This again was a case wherein the Bank of England had granted a license to the BCCI to carry on business as a deposit taking institution. BCCI collapsed in 1991 owing to fraud on a vast scale. Several thousand depositors brought proceedings against the Bank of England seeking recovery of their sums when BCCI collapsed. In that case it was pleaded that the Officers of the Bank of England had acted in bad faith by licensing BCCI when they knew that to do so was unlawful and that the Officers had shut their eyes to what was happening with BCCI after granting the license and had failed to take steps to close BCCI at least by mid 1980s. On a preliminary issue the trial Judge struck out the claim. The House of Lords held that this could not have been done at the preliminary stage and remitted the matter back for trial. But, while so doing, it accepted the principles laid down in the case of Davis (supra). Thereafter in the same case, while remitting the matter back, the House of Lords held that the essential elements should be as follows :

"First, there must be an unlawful act or omission done or made in the exercise of power by the public officer. Second, as the essence of the tort is an abuse of power, the act or omission must have been done or made with the required mental element. Third, for the same reason, the act or omission must have been done or made in bad faith. Fourth, as to standing, the claimants must demonstrate that they have a sufficient interest to sue the defendant. Fifth, as causation is an essential element of the cause of action, the act or omission must have caused the claimants' loss." *

Mr. Sorabjee submitted that in the present case there are no averments. He submitted that even if there were averments these are not matters which could be gone into in writ j jurisdiction as it would require extensive evidence. He submitted that these are matters in which the Court could not pass any order in exercise of its writ jurisdiction.

17. We have heard the submissions of both the parties. Whilst we sympathise with the depositors for their loss, we are unable to accept the submission of Mr. Lalit that the principles laid down in cases relating to breach of Article 21 rights can be applied to cases of loss caused in financial transactions undertaken by individuals with open eyes. In our view the principles laid down in the cases of Yuen Kun-yeu (supra) and Davis (supra) are fully applicable. In our view the principles laid down in Anns' case (supra) have no application to financial transactions. RBI is undoubtedly performing a statutory function. Undoubtedly the general public interest has to be kept in mind by RBI. But that is not the only thing they have to keep in mind. They also have to balance general public interest with the interests and need of Banks and financial institutions. They cannot easily close down a Banking Institution merely because there are a few irregularities. They have to keep in mind the implications of closing a Bank or a financial institution. A closing of a Bank or financial institution has its impact not just on that Bank/financial institution and its customers and debtors but on the future of financial services in that region. Thus, competing interests have to be weighed and balanced.

In hindsight it is easy to point fingers. However, at that stage it would not have been an easy decision for RBI to have closed SBL when it was a major Bank in a small State like Sikkim. One may criticize the decision of RBI to grant SBL a licence to open a Branch in Delhi when the licence under section 22 had not yet been granted. But still that will not be sufficient to foist liability on

RBI to repay all depositors. What the Petitioners want is to foist on RBI liability for the default of SBL. Such liability will be rarely imposed. RBI did not had day to day management or control on SBL. Also the relationship of RBI with creditors or depositors of SBL is not such that it would be just or reasonable to impose a liability in negligence on RBI.

18. Even otherwise we find that there are no proper averments. There is absolutely no averment regarding bad faith. It was fairly admitted by Mr. Lalit that there is no case made out on the basis of public misfeasance. He fairly stated that at the highest the case could only be that of a violation of statutory duties. However, as observed above, compensation for violation of a statutory duty to enable individuals to recoup financial lone has never been recognized in India. In our view the Petitioners having chosen on their own to deposit amounts with the SBL cannot claim to recover against RBI. In such a case the loss has to be allowed to fall where it falls,

19. Under the circumstances, we find no substance in the Writ Petition. The same stands dismissed with no order as to costs.

20. Before parting with the case, we would like to note that financial frauds are on the rise. We find that the police and CBI are not equipped to deal with such cases involving adroit financial manipulations. It is hoped that the Government would now set up a special cell, which has the expertise to unravel such frauds and trace the frauds. Such a cell must have all the powers necessary for investigating, including powers of search and seizure but also be authorized to prosecute the defaulters.

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