SUPREME COURT OF INDIA

Salim Akbarali Nanji

Vs.

Union of India

C.A.No.6715 of 2004

(B. P. Singh and Altamas Kabir, JJ.)

11.05.2006

JUDGEMENT

B. P. SINGH, J.:-

1. This appeal by special leave has been preferred against the judgment and order of the High Court of Judicature at Bombay dated September 18, 2003 in Writ Petition No.2199 of 2003. The High Court by its impugned judgment and order dismissed the writ petition preferred by the appellant holding that the issues raised by the appellant in the writ petition were not justiciable in writ jurisdiction.

2. The appellant has appeared before us in person and argued his appeal. He claims to be a shareholder of the Development Credit Bank Ltd. respondent No.6 herein. In sum and substance, the grievance of the appellant in the writ petition was that the Reserve Bank of India being the statutory and regulatory authority, illegally approved the proposal of the respondent No.6 Development Credit Bank Ltd. for writing off of debts, amounting to Rs.120 crores, of the Bank without following the proper procedures prescribed under the provisions of Sections 13 and 14 of the

Securitisation Act, 2002 and Sections 19 and 31A of the Recovery of Debts Due to Banks Act, 1993.

3. To appreciate the grievance of the appellant it is necessary to notice the background in which the controversy arises.

4. On February 19, 2003, respondent No.6 Bank made a request to the Reserve Bank of India to grant permission and allow the Bank to write off from its financial records, debts that had turned non-performing assets over the years amounting to Rs.120 crores. It was stated in the letter of request, that to institute better balance sheet management and a tighter control environment, the Board of Directors and the principal shareholders of the Bank in France had approved the bank's strategy to write off these debts, subject to approval of the Reserve Bank of India. The Bank had taken necessary steps to recover the dues and will continue to take follow up action, but there appeared no prospect of early recoveries from some of these accounts. The Bank did not expect to generate enough profits to absorb the write off and, therefore, sought permission to allow the write off from the amount lying as General Reserve in the books of the bank as on March 31, 2003, and not from the operating income for the year. It was assured that the Bank was estimated to show capital adequacy well above the minimum limits as prescribed by the Reserve Bank of India even after the amount is transferred for write off. The Bank brought to the notice of the Reserve Bank of India that it had inducted fresh equity capital of Rs.21 crores. The Bank was also actively considering raising subordinated debt amounting to Rs.75 crores to further augment its capital base during the year. It also referred to various other steps being taken to increase its capital base. The letter also refers to the recommendations of M/s. Mekinsey and Co. and the decision of the Board of the Bank to act on its recommendations. In the above background, the Bank sought approval of the Reserve Bank of India to write off an amount of Rs.120 crores from its General Reserve, consequent upon writing off debts to the tune of Rs.120 crores.

5. The Reserve Bank of India by its communication of March 3, 2003 responded to the request of the respondent No.6 Bank and advised the Bank that it may utilize Rs.120 crores from the "Revenue and Other Reserves" to write off the debts that have turned NPAs. The drawal should be "below the line" after arriving at the net profit/loss for the year ended March 31, 2003 on the basis of accepted accounting policies duly approved by the banks Auditors. The above adjustment should be prominently disclosed in the Notes to Accounts.

6. After grant of approval by the Reserve Bank of India, the Annual General Meeting of the Company was held on September 30, 2003 and the write off of the bad debts was approved by the shareholders of the respondent No.6 Bank.

7. In the counter affidavit filed on behalf of the Reserve Bank of India before this Court, it has been stated that the Board of Directors of the respondent No.6 Bank and its principal shareholders

approved the proposal to write off these debts by appropriating the reserves subject to receiving approval from the Reserve Bank of India. Referring to Section 17(1) of the Banking Regulation Act, 1949, it was explained that every banking company incorporated in India must create the reserve fund and shall out of the balance of profit of each year as disclosed in the profit and loss account prepared under Section 29 of the Act, and before any dividend is declared, transfer to the reserve fund a sum equivalent to not less than 20% of such profit. The said limit was raised to 25% in December 1974. In terms of Section17(2), a banking company can appropriate sums from the reserve fund or the share premium account, and the same must be reported to the Reserve Bank of India within 21 days explaining the circumstances relating to such appropriation. This implies that appropriation of the statutory reserve fund does not require the Reserve Bank's prior approval though there is a statutory obligation on banks to report appropriation to the Reserve Bank of India. The appropriation of other reserves does not cast any obligation on banking companies to report to the Reserve Bank. However, as a matter of practice, the banking companies are approaching the Reserve Bank for permission before appropriating their reserves for writing off the bad debts. The Reserve Bank considers the financial position of the applicant banking company before granting permission to utilize the reserves for the purpose.

8. Dealing with the facts of this case, it was averred that the respondent No. 6 Bank had earned a net profit of Rs. 34.05 crores during the financial year 2001-02 and transferred Rs. 8.55 crores to statutory reserve and Rs. 0.30 crore to investment fluctuation reserve. The gross and net NPAs of respondent No. 6 Bank were Rs.215.45 crores and Rs.149.33 crores respectively as on March 31, 2002. The Capital to Risk-weighted Assets Ratio (CRAR) was at 11.49% as on March 31, 2002. Even after the amount was transferred from the reserves for write off as on March 31,2003, the CRAR stood at 10.08%, which was above the minimum prescribed CRAR of 9%. During the year 2002-03, an amount of Rs. 21 crores has been induced as fresh equity capital by the principal shareholders of the banking company. After taking into consideration the above facts and the need for cleansing the balance sheet of the Respondent No. 6-Bank, the Reserve Bank has allowed it to utilize Rs.120 crores from the revenue and other reserves to write off debts that have turned NPAs, vide letter DBOD. No.PSBS.1036/16.01. 132/2002-03, dated March 3, 2003.

9. It was further explained that the write off is an internal accounting procedure to clean up the balance sheet of the Bank. Such write off is resorted to even in cases where the Bank has not exhausted all the avenues for recovery of dues. Such write off does not affect the right of the Bank to proceed against the borrowers to collect the dues. The legal proceedings initiated by the Bank to recover the loans or to enforce the security against the borrowers may continue. The write off does not bar the Bank from following up recoveries. Further recoveries, if any, in these accounts are credited to the income account, in turn improving the net worth of the Bank. Replying to the petitioner's allegation that the Reserve Bank had failed to exercise its statutory powers and authority of law against the Bank under the various provisions of the Banking Regulation Act, 1949 to restrain it from taking any steps or acting in furtherance to write off the secured debts of the sum of Rs.120 crores, which is detrimental to the interests of the Bank, its depositors, investors and shares-holders, it was submitted that the banking companies do not need Reserve Bank's permission to write off bad debts. As mentioned earlier, the banking companies are also not under statutory obligation to seek the Bank's approval for appropriation of sums from their reserves. However, as a matter or practice, the banking companies do approach the Reserve Bank for permission, before

utilizing their reserves, for writing off the bad debts and the Reserve Bank grants approval, if it is in order, on considering their financial position and other related factors as stated above.

10. In its counter-affidavit filed before this Court the respondent No. 6-Bank stated that the dues from various debtors had necessarily to be shown as non-performing assets (NPAs) as per the guidelines issued by the Reserve Bank of India. The Reserve Bank of India monitors the NPAs strictly and during the periodical inspections, goes into the matter of NPAs in detail. The Reserve Bank of India had issued a circular letter dated July 28, 1995, and has been issuing circulars/directions/guidelines from time to time prescribing the manner in which NPAs could be categorized and where and how amounts should be written off. Compliance of these guidelines is rigorously monitored by the Reserve Bank of India at the time of periodic inspections. The last such detailed periodic inspection by the Reserve Bank of India in the case of respondent No. 6-Bank was conducted sometime in September, 2003 when all these and other matters were gone into by the Reserve Bank of India.

11. It is further stated that respondent No.6-Bank was negotiating with several reputed foreign investors, including International Financial Corporation, Washington (IFC), for a major infusion of capital into Bank. The foreign investors including IFC, Washington indicated to the respondent No.6-Bank that they would very much like to see the Bank's balance sheet cleaned up by writing off the NPAs and especially so because the respondent No.6-Bank had accumulated huge reserves which had been built up out of the profits earned by the Bank since 1995. The write off of the amounts of NPAs against the reserves of the Bank was, therefore, a book entry with the object of cleaning up the balance sheet and without any prejudice to the Bank's right to continue with the proceedings to recover the amounts from the debtors in question.

12. It was reiterated that the mere write off of a debt by the Bank did not require the prior permission or subsequent approval of the RBI. However, if bad debt is to be written off against the reserves, it is necessary for the Bank to intimate the RBI. The normal practice being, however, to apply to RBI for approval, the respondent No.6-Bank had approached the RBI by its letter dated February 19, 2003. Thereafter, the Reserve Bank of India, by its letter dated March 3, 2003 granted approval for the write off of the bad debts against the reserves of the Bank. It is also important to note that the audited profit and loss account and the balance sheet of the Bank were approved at the Annual General Meeting held on September 30, 2003 by an overwhelming majority of the shareholders, by show of hands and the appellant was present in the said meeting. It was, therefore, submitted that the write off of the bad debts has also the approval of the shareholders of the Bank, and the same gives a true and fair view of financial position of the Bank. Such write off is also pre-eminently in the interest of the Bank and all its shareholders.

13. The Bank has, further, explained that almost 80% of the NPAs/bad debts relate to the loans advanced to 15 parties. The particulars about these 15 parties and the steps taken by the Bank to recover the amounts due, have been set out in the counter-affidavit which was filed in compliance of

the order of this Court dated July 5, 2004.

14. It will thus appear from the facts noticed above that the writing off of NPAs is an exercise undertaken to clean the balance sheet, and is an internal accounting procedure. It does not require the permission of the Reserve Bank of India but as explained by the Reserve Bank of India, banks usually make such a request as a matter of practice and permissions are granted by the Reserve Bank after considering all relevant aspects of the matter. In the case where a banking company appropriates sums from the reserve fund or the share premium account, it is required to report to the Reserve Bank of India within 21 days explaining the circumstances relating to such appropriation.

15. In the instant case also since the respondent No.6-Bank proposes to appropriate the sums from their reserves, it sought by way of abundant caution the approval of the Reserve Bank of India. There is, therefore, no justification for the grievance that in granting approval to the bank to write off its non-performing assets to the tune of Rs.120 crores, the Reserve Bank of India committed breach of any statutory provision or acted illegally or arbitrarily in the matter. There is not even an allegation that the Reserve Bank of India acted on extraneous consideration, or that its action was mala fide.

16. The appellant submitted before us that writing off of Rs.120 crores would cause a great loss to the Bank, because the sum of Rs.120 cores would be lost to the bank. He submitted that it is not as if the loans cannot be recovered. In most cases, securities are provided before loans are advanced. There are guarantors against whom the Bank can proceed. In these circumstances, there was no justification for the Bank to write off these debts.

17. The submission proceeds on the assumption that the bad debts written off cannot be recovered. In fact and in law it is not so. Despite writing off the debt is still recoverable by the Bank. The affidavit filed by the Bank also discloses the steps which are being taken to realize the dues from the debtor. Some amounts have been recovered over the years though the figure does not appear very impressive. Even so, steps are being taken to recover the dues whenever possible and respondent No.6-Bank has furnished particulars of the various proceedings pending for recovery of such debts. The write off is only an internal accounting procedure to clean up the balance sheet, and it does not affect the right of the creditor to proceed against the borrower to realize his dues. Moreover, it does give some benefit to the Bank under the Income Tax Laws because after write off tax is payable only on the amount recovered as and when recovery is made. In the guidelines issued by the Reserve Bank of India, it is observed :

"Writing-off of NPAs - In terms of Section 43-D of the Income- tax Act, 1961, income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the RBI in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the bank's profit and loss account or received, whichever is earlier.

This stipulation is not applicable to provisioning required to be made as indicated above. In other words, amounts set aside for making provision for NPAs as above are not eligible for tax deductions.

Therefore, the banks should either make full provision as per the guidelines or write-off such advances and claim such tax benefits as are applicable, by evolving appropriate methodology in consultation with their auditors/tax consultants. Recoveries made in such accounts should be offered for tax purposes as per the rules."

18. The appellant submitted before us that the Reserve Bank of India had failed to exercise the statutory powers vested in it and, therefore, it failed to perform a legal duty cast upon it by law. The appellant was, therefore, entitled to invoke the writ jurisdiction of the High Court for issuance of Writ of Mandamus to the Reserve Bank of India to act in accordance with its statutory obligations. In this connection, reference has been made to Sections 21, 22(4), 27, 30, 35, 35A, 36, 36AA, and 45 of the Banking Regulation Act, 1949.

19. Section 21 of the Banking Regulation Act empowers the Reserve Bank to determine the policy in relation to advances to be followed by banking companies generally, or by any banking company in particular. The policy, if so, determined by the Reserve Bank of India in public interest or in the interest of depositors or banking policy, must be followed by all banking companies. In the instant case there is no material whatsoever to demonstrate that the Reserve Bank of India has failed to exercise its powers under Section 21 of the aforesaid Act, nor is there anything to prove that the respondent No.6-Bank herein has not followed any policy so determined by the Reserve Bank of India.

20. Section 22 (4) of the aforesaid Act empowers the Reserve Bank of India to cancel a licence granted to a banking company in the circumstances mentioned therein. We fail to understand how the said provision is at all relevant since it is not the case of the appellant that the licence granted to the respondent No.6-Bank should be cancelled.

21. Section 27 casts an obligation on every banking company to submit to the Reserve Bank a return in the prescribed form and manner showing its assets and liabilities in accordance with the aforesaid provision. The Reserve Bank is also authorized at any time to direct a banking company to furnish it such statements and information relating to the business or affairs of the banking company as it may consider necessary or expedient to obtain for the purposes of the Act. We fail to understand how Section 27 is at all relevant in the instant case because it is not the case of the appellant, nor has any material being placed on record to show, that there has been breach of Section 27 of the aforesaid Act.

22. Similarly, Section 30 which deals with audit of the balance sheet and profit and loss account of a banking company by a qualified auditor is not at all relevant. Sub-Section (1B) of Section 30 empowers the Reserve Bank to order a special audit. In the instant case we are not concerned at all with the appointment of auditors.

23. Section 35 relates to inspection of banking companies. It empowers the Reserve Bank to cause an inspection to be made by one or more of its officers of any banking company and its books and accounts.

24. Section 36 enumerates the other powers and functions of the Reserve Bank. Similarly Section 36-AA empowers the Reserve Bank to remove from office any Chairman, Director, Chief Executive Officer or other officer or employee of the banking company, subject to the conditions laid down in that provision.

25. Section 45 confers power on the Reserve Bank to apply to the Central Government for suspension of business by a banking company and to prepare scheme of reconstitution or amalgamation. We fail to appreciate how any of these provisions is relevant to the issue that arises in the instant appeal. No doubt, the Reserve Bank has been vested with wide powers to control and regulate the functioning of banks. If need be, those powers may be exercised by the Reserve Bank. In the instant case, we are only concerned with the writing off of non-performing assets. Nothing has been produced on record to satisfy us that the Reserve Bank has acted in breach of its legal obligations in the matter of granting permission to the respondent No.6-Bank to write off the debts that have become non-performing assets.

26. The appellant made a general submission that there was no justification for writing off the bad debts amounting to Rs.120 crores. Respondent No. 6-Bank should have taken all necessary steps to recover the debts and to enforce its rights under Sections 13 and 14 of the Securitisation Act, 2002 and Sections 19 and 31-A of the Recovery of Debts Due to Bank Act, 1993. The Bank can proceed against the original security and the secured assets of the borrowers and recover its dues. Writing off bad debts was detrimental to the interest of a banking company.

27. It is no doubt true that amounts advance by banks must be recovered. Such debts should not be permitted to become non-performing assets. However, one cannot lose sight of the realities of the situation. Having regard to the nature of banking business, it is possible that the Bank may commit an error of judgment in advancing funds to a particular party or industry. It may be that on account of other factors beyond its control, or even beyond the control of the borrowers, it may become difficult, or even impossible to recover the loan advanced in accordance with the schedule of re-payment, or to recover the loan at all. These are risks inherent in the banking business, though a

wise banker with foresight and anticipation may reduce such risks to the minimum level. One cannot, however, jump to the conclusion that only because some of the debts have become bad, there is lack of proper management of the Bank, or that the conduct of the Bank is dishonest or mala fide. In a given case, there may be evidence of such mis-management or dishonest conduct, but in the absence of any such accusation one cannot draw an adverse inference against the Bank. In the instant case, though some of the debts have to be written off, with little chance of substantial recovery, we cannot lose sight of the fact that the Bank has generated considerable operating profits and has built up a substantial general reserve over the years, against which the debts written off have been adjusted.

28. We, therefore, find no merit in this appeal. The same is accordingly dismissed but without any order as to costs.

29. The issues involved in this case are the same as in the connected civil appeal which we have dismissed by our judgment and order today. In this case as well the petitioner prayed for quashing or setting aside the permission granted by the Reserve Bank of India to the respondent-Bank to write off the non-performing assets. The petitioner had filed a writ petition before the High Court of Judicature at Bombay being Writ Petition No. 2615 of 2004. By our order dated July 25, 2005, the case was transferred to this Court so as to be heard and disposed of with the connected civil appeal. This case is also dismissed but without any order as to costs.

Order accordingly.