

Salgaonkar

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IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION
WRIT PETITION NO.2575 OF 2023

Saket Kamleshkumar Agarwal .. Petitioner

Versus

Indian Overseas Bank & Ors. .. Respondents

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Mr.Naushad Engineer, Senior Counsel with Ms.Ankita Singhania, Mr.Yohaann Llimathwalla, Mr.Ranjit Shetty, Mr.Rahul Dev and Ms.Risha Alva i/b Argus Partners for the Petitioner.

Mr.Siddha Pamecha with Ms.Neha Jasuja i/b Thodur Law Associates for the Respondent-Bank.

**CORAM: BHARATI DANGRE &
MANJUSHA DESHPANDE, JJ.**

DATE : 29th APRIL, 2026

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ORAL JUDGMENT [PER BHARATI DANGRE, J.]

1. Rule. Rule is made returnable forthwith, by consent of the parties.

2. The Master Circular on 'Wilful Defaulters' issued by the Reserve Bank of India (for short, "RBI") on 01/07/2015, has defined the term 'Wilful Default' in clause 2.1.3 as below :-

"2.1.3 Wilful Default: A 'wilful default' would be deemed to have occurred if any of the following events is noted :

- (a) The unit has defaulted in meeting its payment/repayment obligations to the lender even when it has the capacity to honour the said obligations.
- (b) The unit has defaulted in meeting its payment/repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.

- (c) The unit has defaulted in meeting its payment/repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.
- (d) The unit has defaulted in meeting its payment/repayment obligations to the lender and has also disposed off or removed the movable fixed assets or immovable property given for the purpose of securing a term loan without the knowledge of the bank/lender.

The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions/incidents. The default to be categorised as wilful must be intentional, deliberated and calculated.”

3. The RBI, has issued the Circular pursuant to the instructions of the Central Vigilance Commission for collection of information on wilful defaults of Rs.25 lakhs and above and dissemination to the reporting banks and financial institutions and, therefore, a scheme is formulated for submitting the RBI the details of the wilful defaulters.

4. The Petitioner, in his capacity as Director of M/s Tuticorin Coal Terminal Private Limited, received a show cause notice dated 09/07/2021 from the Indian Overseas Bank, stating that the borrower company-M/s Tuticorin Coal Terminal Private Ltd. had availed various credit facilities from the Bank at its new Marine Lines Branch against security of assets and the liabilities under the above transactions were acknowledged from time to time. As far as the Directors/Promoters i.e. noticee Nos.2 to 9 are concerned, it was stated that they were in charge of day-to-day affairs of the company and the noticee Nos.2 to 4 had extended personal guarantee in respect of the financial facility enjoyed by the borrower from the Bank.

The notice further clarified that the borrower had failed to honour the contractual repayment obligation in terms of the loan documents and security documents and its account was classified as NPA as on 01/01/2016 under the RBI guidelines and this was informed to the noticees.

5. For the purposes of asking the noticees to show cause as to why the proceedings shall not be initiated against them to declare them as 'wilful defaulters' in the wake of the RBI guidelines and asking them to submit their reply, the notice makes reference to the internal review conducted by the Bank, with an observation that the noticees have continuously defaulted in payment/repayment obligations in violation of agreed terms and acted in a manner, set out therein, which is deemed to be an act of 'wilful default' as per the RBI guidelines.

Paragraph No.5 thereafter, has made reference to the borrower's action substantiating the event of default and various such events with reference to the audit observations are set out.

Reference is also made about Forward Contract for Purchase/Sale of Foreign Currency and the observation is also on the cancellation of Foreign Currency Contract.

6. A careful reading of the tabulation of the borrower's action, set out as substantiating the event of default and which according to the notice, is deemed to be an act of wilful default, will reveal that there is mention of various events, which may at the most, seen to be some diversion, as it is stated that the capital advance to the borrower was in aggregate of Rs.20.64 crores, which has been debited to some parties, which

remained status quo from 31/03/2016 to 31/03/2017 and nothing against the said amount has been booked as purchase or expense during this period and even the break-up of the said advances was not provided to the auditors.

Then there is a reference to Round Tripping of Funds, by rotation between different bank accounts to bring back the same amount as equity received with reference to an Escrow Account, the details of which are provided in the chart, which reflect that there are certain fund transfers made from the Escrow Account. In this regard, there is a reference to the audit observation, which record that by way of two transactions of Rs.15,25,000/- each, the amount was transferred to BOI from the Escrow Bank Account and the same was introduced on same date after the said transfer in chronology as equity by ALBA and this pattern was recorded to be sufficient to bring scepticism over the Round Tripping of bank finance into Equity capital infusion.

Similarly, it is also recorded that the auditors have found instances where closing balances as reflected in the audited financial statements did not match with the actual closing balances standing in Bank Statement as on the last date of the audited year.

7. It is in the background of the above events, it is construed that the noticees are wilful defaulters and as far as the Petitioner is concerned, he being referred to as the Promoter/Director and responsible for managing the affairs of the business of the borrower and having extended guarantee for the financial facilities enjoyed by the borrower, the show cause notice has been issued, as per the RBI guidelines.

8. The learned senior counsel Mr.Naushad Engineer, representing the Petitioner, at the outset would submit that the show cause notice is based on some incorrect information; the first of it being that the Petitioner, is one of the Guarantors, but he had never offered guarantee for the services availed from the Bank by the borrower. The second flaw, according to him, is the narration in the notice that the loan account of the borrower is classified as NPA on 01/01/2016, as per the RBI guidelines, and he would invite our attention to the two communications from the Bank; the first one dated 29/01/2016 and the second one dated 14/09/2018 addressed to the borrower company, reflecting the status of the account and on perusal of the same, he would submit that though there was some amount outstanding against the sanctioned limit, the overdue amount is shown to be Nil.

Apart from this, it is also his specific contention that there cannot be any thing like “deemed act of wilful default” as the RBI guidelines have specifically defined as to what events would attract “a wilful default” and in absence of any indication in the show cause notice as to what event, according to the Bank, has triggered the initiation of action under the Wilful Default Circular, it is impossible for the Petitioner to respond.

9. Relying upon the recent decision of the Apex Court in the case of *J.Sri Nisha Vs. The Special Director, Adjudicating Authority, Directorate of Enforcement & Anr.*¹, it is the submission of the learned senior counsel that though the Writ Court in its jurisdiction may refrain itself from showing

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indulgence in a show cause notice, however, the parameters for interference at the stage of show cause notice in exceptional circumstances, are now widened and five of such factors have been set out by the Hon'ble Apex Court, which include non-application of mind as well as the notice suffering from patent lack of jurisdiction.

10. Mr.Pamecha, the learned counsel representing the Respondent No.1-Bank, would vehemently submit that the show cause notice is clear, when it indicated to the noticees that the action stipulated therein by the borrower substantiate the event of default and he would submit that there are serious objections, which are based on audit observation, and, therefore, warrant an action under the Circular of the RBI.

11. In reference to the definition of the term 'wilful default' in the Master Circular issued by the RBI, it is categorically stated that a wilful default would be deemed to have occurred, if the events specified in sub-clauses (a) to (d) of clause 2.1.3 have occurred. The net result of all those events set out in the aforesaid sub-clauses must ultimately result in 'Default' by the unit in making payment/fulfilling its repayment obligations to the Lender and the various instances set out in the said clause, ultimately must lead to default in making of payment/repayment obligations.

Clause 2.1.3 has different shades of such a default, as a default can occur when the borrower make default in payment, despite it having capacity to honour the said obligations or the default occur when the borrower has not utilised the

finance from the lender for the specific purpose for which the finance was availed, but has diverted the funds for other purposes or that the borrower has siphoned off the funds, so that the funds have not been utilised for the specific purpose for which the finance was availed. Another category set out in sub-clause (d) is, when the borrower has disposed off or removed the movable fixed assets or immovable property given for the purpose of securing term loan, without the knowledge of the lender.

The Circular also specifically state that the identification of the wilful default should be made keeping in view the track record of the borrowers and shall not be decided on the basis of isolated transactions/incidents and the default to be categorised as wilful must be “Intentional, Deliberate and Calculated.”

Not only this, the Circular thereafter has explained the various terms which are employed in clause 2.1.3., namely, ‘diversion of funds’; ‘Siphoning of funds’; ‘end-use of funds’ and it is evidently clear from reading of the guidelines, that only in respect of those events, which are reflected in clause 2.1.3 of the Circular, the action under Master Circular on ‘Wilful Defaulters’ can be triggered.

12. Juxtaposed against these guidelines by the RBI, when we perused the show cause notice and despite we repeatedly asking to the learned counsel for the Bank to point out as to how and which of the events, which are set out in para 5, would amount to an event of ‘wilful default’ and it would fit in which of the sub-clauses of clause 2.1.3 of the Circular, we are unable to fetch any answer from him.

We have noted that the show cause notice refers to various acts, which may amount to non-utilisation of funds or routing of the funds through different channels, but the test for applying or invoking the provisions of the Circular is that such events have ultimately resulted in a default in discharge of liabilities/obligations to the lender bank.

13. In *J.Sri Nisha* (supra), the Hon'ble Apex Court has categorically laid down the parameters on which a Writ Court would be entitled to interfere against the show cause notice, though it may not be by way of an inviolable rule and the Apex Court has observed thus :-

"32.Interference at the stage of SCN is permissible in exceptional circumstances, such as where the notice suffers from patent lack of jurisdiction, reflects non-application of mind, is issued with a pre-determined or premeditated approach, amounts to an abuse of the process of law, or results in a violation of the principles of natural justice. In such situations, the High Court would be justified in exercising its jurisdiction under Article 226 of the Constitution to prevent manifest injustice. In this context, we may gainfully refer to the following observations from *Union of India v. VICCO Laboratories*[(2007) 13 SCC 270] :-

"31. Normally, the writ court should not interfere at the stage of issuance of show-cause notice by the authorities. In such a case, the parties get ample opportunity to put forth their contentions before the authorities concerned and to satisfy the authorities concerned about the absence of case for proceeding against the person against whom the show-cause notices have been issued. Abstinance from interference at the stage of issuance of show-cause notice in order to relegate the parties to the proceedings before the authorities concerned is the normal rule. However, the said rule is not without exceptions. **Where a show-cause notice is issued either without jurisdiction or in an abuse of process of law, certainly in that case, the writ court would not hesitate to interfere even at the stage of issuance of show-cause notice.** The interference at the show-cause notice stage should be rare and not in a routine manner. Mere assertion by the writ petitioner that notice was without jurisdiction and/or abuse of process of law would not suffice. It should be prima facie established to be so. Where factual adjudication would be necessary, interference is ruled out.

[Emphasis supplied]"

14. In our view, this is a fit case, where we are of the view that such an exception deserve to be granted, as when the show cause notice suffers from patent lack of jurisdiction and is reflective of non-application of mind, the Writ Court is definitely bound to step in and set right the wrongful action, which has arisen on account of show cause notice being issued.

The whole purpose of show cause notice is to apprise the noticee of what accusations/charges he has to meet and, therefore, the show cause notice issued is expected to state with clarity, as to what are the factors, which are taken into consideration for considering the reply to the notice for a contemplated action.

The term 'wilful default' having been specifically set out in the Circular and even the Circular of the RBI has set out the events, which may ultimately result into default in meeting of the payment/repayment obligations to the lender by the borrower. In our view, the show cause notice has failed to make any such case falling within sub-clauses (a) to (d) of clause 2.1.3 of the Master Circular on Wilful Defaulters dated 01/07/2015.

Therefore, we are of the view that the impugned show cause notice issued qua the Petitioner, is liable to be quashed and set aside, though we reserve the liberty in the Bank to initiate action, if at all it is competent for it to do so, by strictly following the Guidelines issued by the Reserve Bank of India.

The Writ Petition is made absolute in the aforesaid terms.

(MANJUSHA DESHPANDE, J.)

(BHARATI DANGRE, J.)