IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

WRIT PETITION NO. 2545 OF 2021

1. Ravi Arya, 67 years, residing at 6, Satlaj Terrace, 6, Satlaj Terrace, Walkeshwar Road, Mumbai 4000006.
2. Nakul Arya, aged about 40 years. Residing at 6, Satlaj Terrace, 6, Walkeshwar Road, Mumbai 400006. .. Petitioners

Versus

1. The Reserve Bank of India, through its Governor, Having its office at 18th Floor, Central Office Blddg, Mumbai 400001.

2. Bank of Baroda, Head office at Baroda Bhavan, 7th floor, Vadodara, Gujarat, ant its Asset Recovery Management Branch at Dena Bank Bhavan, Gr. Floor, 3rd Pasta Lane, Colaba, Mumbai 400005. .. Respondents

3. Union Bank of India, Union Bank Bhavan, 239, Vidhan Bhavan Marg, Nariman Point, Mumbai 400021.

...

Mr. Vikram Nankani, Senior Advocate with Mr.Jas Sanghavi and Durgaprasad Poojary i/b PDS Legal for the petitioners.
Mr.Prasad Shenoy with Ms.Aditi Phatak, Paricher Zaiwalla, Ishita Desai, Parag Sharma, Megha More and Juhi Bhayani i/b BLAC Co. for the Reserve Bank of India, respondent no.9.
Mr.A.R. Bamne i/b A.R. Bamne and Co. for respondent no.2.
Mr.Priyam Amin i/b N.N. Amin Co. for respondent no.3.

Tilak

CORAM : BHARATI DANGRE &
R.N. LADDHA, JJ
RESERVED ON: 7th JANUARY 2026.
PRONOUNCED ON: 25th MARCH, 2026

JUDGMENT (Per Bharati Dangre, J)

1. The two petitioners, Ravi Arya and Nakul Arya, the Directors of International Mineral Trading Private Limited (hereinafter referred to as 'IMTC') have approached this Court, seeking declaration that the continued penal measures stipulated in paragraph no.2.5(a) of the Master Circular on Wilful Defaulters dated 1/7/2015 issued by Reserve Bank of India is not applicable in case of a successful compromise settlement and consequent recall/withdrawal of Wilful Defaulter by the lender bank, and the petition seek the following reliefs :-

> *"(a) this Hon'ble Court be pleased to hold/declare that the continued penal measure stipulated in paragraph 2.5 (a) of the "Master Circular on Wilful Defaulters" dated 01.07.2015 issued by the Reserve Bank of India (copy at Exhibit-A infra), is inapplicable in a case of successful compromise settlement and consequent recall/withdrawal of declaration of wilful defaulter by the Lender Bank by removal from the list of wilful defaulters and also in a case of recall of erroneous declaration of wilful defaulter by removal from the list of wilful defaulters.*
>
> *(a1) that this Hon'ble Court be pleased to issue a Writ of Certiorari or a writ in the nature of Certiorari or any other writ, order or direction under Article 226 of the Constitution of India calling for the records pertaining to the Petitioners' case and and after going into the validity and legality thereof to quash and set aside the impugned order dated 16.05.2017 of CoE (which was never communicated to the Petitioner) and decision of Review Committee dated 19th July, 2017 passed by the Review Committee of the Respondent no. 2, with consequential reliefs;*
>
> *(b) this Hon'ble Court be pleased to declare that all Banks and Financial Institutions would be free to consider, approve and finance on the petitioners' proposal for seeking finance in respect of any new venture, on its own merits, without being hindered by the*

impugned paragraph 2.5(a) of the "Master Circular on Wilful Defaulters" dated 01.07.2015".

2. We have heard learned senior counsel Mr. Vikram Nankani for the petitioners, Mr.Shenoy for the Reserve Bank of India and Mr. A.R. Bamne for respondent no.2.

By consent of the parties, we issue Rule. Rule is made returnable forthwith.

3. IMTC availed credit facility from Bank of Baroda, a Public Sector Undertaking and the Body Corporate constituted under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, by filing an application, pursuant to which it sanctioned the term loan of 115.00 Crores on 22nd December 2008. In consideration of the aforesaid, IMTC executed various security documents in favour of the Bank, and by way of further security, the petitioners along with other Directors of IMTC jointly executed a joint General Form of Guarantee in its favour of Bank of Baroda, thereby guaranteeing repayment of the amounts due under the credit facility. Additional credit facility was granted to IMTC by respondent no.2 in the sum of Rs.90.00 Crores and the earlier term loan was also reviewed in the sum of Rs.205.00 Crores on the terms and conditions set out in the sanction letter. Even for this facility, IMTC executed security documents and the Directors/Promoters executed separate Deeds of Guarantee in favour of Bank of Baroda, guaranteeing the repayment of the amounts under the credit facility.

4. On account of the purported default, Bank of Baroda declared the account of IMTC as 'Non-Performing Asset' and initiated proceedings under the SARFAESI Act, 2002 (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest), to enforce the securities and also simultaneously initiated proceedings to declare the petitioners as 'Wilful Defaulters'.

The promoters of IMTC filed Writ Petition (OS) St No.549/2018 impugning the communication of declaration of Wilful Defaulter and threatening its publication in the newspaper.

However, worth it to note that the petition was rejected on 5/3/2019 in the wake of the order passed by the Prothonotary and Senior Master, and in the meantime since there was already a compromise settlement, under a bonafide belief that the petition has become infructuous, no steps were taken by the petitioner for its adjudication on merits.

5. While proceedings were pending under the SARFAESI Act, as a result of a correspondence being entered between Bank of Baroda and IMTC, and/or its Directors and Promoters, a One Time Settlement was arrived at, and the entire outstanding dues payable to Bank of Baroda were paid in full and it even issued a 'No Due Certificate' in favour of IMTC.

6. Closing the aforesaid chapter when the petitioners approached the Union Bank of India, respondent no.3, for financial assistance, they have apprehended that in view of para

2.5(a) of the Master Circular of Wilful defaulters dated 1/7/2015, they are not entitled for any institutional finance for a period of five years.

7. The petitioners have approached the Court, raising a challenge to the penal measures stipulated in paragraph 2.5(a) of the Master Circular of 1/7/2015 issued by the RBI to the limited extent of it being made applicable to the petitioners, by construing it as a bar for grant of on institutional finance to them, or any other Company promoted by them for a period of five years, despite recall/withdrawal of the declaration of 'wilful default' by removal of their names from the list of 'wilful defaulters' by the lender bank i.e. Bank of Baroda, pursuant to a successful compromise settlement between IMTC and the Bank.

By amending the petition, challenge is also raised to the decision of the Review Committee of the respondent no.2 dated 19/7/2017, when the Review Committee confirmed the decision to place the petitioners in the list of wilful defaulters.

8. Learned senior counsel Mr. Nankani in support of the petition, which pray for reading down of the stipulation contained in paragraph 2.5(a) of the Master Circular, which has debarred the petitioners for availing institutional finance for a period of five years, despite a clarification being contained in explanation appended to para 2.9 of the Master Circular, where the Bank is not under an obligation to report cases where a compromise settlement is effected and the borrower has fully paid the compromise amount. According to him, the Master

Circular has therefore, created an ambiguous situation, as its intention appear to be that successful compromise settlement do not warrant penal actions contemplated for 'wilful defaulters'.

Highlighting the purpose underlying the Master Circular in disseminating the credit information, according to Mr. Nankani, it is only with a view to the caution Banks and Financial Institutions, so as to ensure that further bank finance is not made available to 'wilful defaulters' It is his submission that nowhere the intention is indicated of any continued penal measures against those who cease to be 'wilful defaulters' as such declaration is recalled/revoked by the lender bank itself, pursuant to a compromise settlement being reached or the declaration found to be erroneous.

9. In the instant case, according to Mr.Nankani, for the reasons beyond the control of the petitioners, such as adverse market scenario and viability crisis on account of techno commercial reasons, the standalone Iron Ore beneficiation plant set up by IMTC, despite infusion of substantial funds of the promoters and the term loan could not successfully function for desired quality and quantity of production to cater to the Group's existing Pellet plant in India. The personal guarantees of the promoters/directors was obtained in the year 2009 and 2013 and according to Mr.Nankani, significant amount was paid to Bank of Baroda by the promoters by infusing further funds after closure of the plant to service the debts as the unit

by itself had no capacity to clear the debts. He would submit that the entire assets of IMTC, including the plant and machinery was auctioned by Bank of Baroda for recovery of its dues.

It is thus his submission that without any deliberate and calculated attempt of siphoning or diversion of funds or non-payment by the unit, being established to be intentional, Mr.Nankani would urge that the petitioners could not have been categorized as 'wilful defaulters'.

According to him, the classification of petitioners as 'wilful defaulters' must receive requisite evidence, clearly spelling out the reasons for which the borrower has been declared as wilful defaulter, and the default must be categorized as intentional, deliberate and calculated.

Further, according to the learned Senior Counsel, the Executive Committee ought to have passed a reasoned order, against which there is a provision for opportunity to represent to the Review Committee which is under an obligation to pass a reasoned order on the representation, which must be then served on the borrower.

10. Though the petition raises various objections as to why the classification of the Petitioners in the list of wilful defaulters itself is erroneous, Mr.Nankani would focus on the aspect of penalty measures, as provided under the Master Circular, despite a 'No Due Certificate', being issued in favour of IMTC in the wake of the compromise settlement on 3/4/2021, certifying

that no further amount is to be received from the borrower in the account of M/s. International Minerals Trading Company Pvt. Ltd, as per the settlement.

Mr.Nankani would place reliance upon the decision of the Apex Court in **State Bank of India Vs. Jah Developers Private Limited and ors**[1], **and Gorkha Security Services Vs. Government (NCT of Delhi) and ors.**[2]

11. Learned counsel appearing for the Bank of Baroda has submitted that by passage of time, the petition has been rendered in fructuous as the loan account of IMTC which was rendered NPA in the wake of the compromise settlement is closed on issuance of 'No Due Certificate'.

12. The learned counsel Mr. Shenoy for the RBI, however, has strongly contested the challenge and he would submit that since the Master Circular is issued by the RBI to have a system in place to disseminate credit information pertaining to wilful defaulters, the same being issued in exercise of it's legislative power and as Circular has the force of law, the Court shall exercise restrain while interfering with such delegated legislation and declaring the same as invalid on the ground of unreasonableness.

According to him, a bylaw do not become 'unreasonable' merely because particular Judges may think that it is so, and he would invoke the principle laid down by the Apex Court in its authoritative pronouncement to test the validity of delegated

1 (2019) 6 SCC 787
2 (2014) 9 SCC 105

legislation and one such decision on which he placed reliance is in the case of **State of Tamil Nadu and Anr. P. Krishnamurthy and ors,**[3] and the relevant observation deserve a reproduction:-

> *"12. There is a presumption in favour of constitutionality or validity of a sub-ordinate Legislation and the burden is upon him who attacks it to show that it is invalid. It is also well recognized that a sub-ordinate legislation can be challenged under any of the following grounds :-*
>
> *a) Lack of legislative competence to make the sub-ordinate legislation.*
>
> *b) Violation of Fundamental Rights guaranteed under the Constitution of India.*
>
> *c) Violation of any provision of the Constitution of India.*
>
> *d) Failure to conform to the Statute under which it is made or exceeding the limits of authority conferred by the enabling Act.*
>
> *e) Repugnancy to the laws of the land, that is, any enactment .*
>
> *f) Manifest arbitrariness/unreasonableness (to an extent where court might well say that Legislature never intended to give authority to make such Rules).*

13. According to Mr.Shenoy, the challenge in the petition about continuing the debarment for a period of five years from the date of removal of the name from the wilful defaulter list as 'arbitrary', will have to be tested in light of the above principle as it is his submission that in order to strike down the delegated legislation as arbitrary, it has to be established that there is manifest arbitrariness and in order to describe it as arbitrary, it must be shown that it was not reasonable and manifestly arbitrary i.e. in an unreasonable manner as fixed or done capriciously or at pleasure, without adequate determining principle, not founded in the nature of things, non-rational,

3 (2006) 4 SCC 517

non-done or acting according to reason or judgment, depending on the will alone.

14. The second challenge of the petitioners based on the principles of fundamental rights i.e. violation of 19(1)(g) and Article 21, ought to be tested on the basis of proportionality test, as set out in **K.S. Puttuswamy vs Union of India,**[4] is Mr. Shenoy's submission.

According to him, the proportionality test involves four step test:-

> (i) A measure restricting a right must, first, serve a legitimate goal (legitimate goal stage);
> (ii) It must be a suitable means of furthering this goal (suitability or rational connection stage);
> (iii) There must not be any less restrictive but equally effective alternative (necessity stage);
> (iv) The measure must not have a disproportionate impact on the right-holder (balancing stage).

15. Justifying the stand of the RBI and inclusion of such a stipulation, Mr.Shenoy would submit that pursuant to the instructions of the Central Vigilance Commission for collection of information on Wilful defaults of Rs. 25 lakhs and above by RBI and dissemination to the reporting banks and FIs, a Scheme was framed by the Reserve Bank, under which the banks and financial institutions ARE required to submit to RBI the details of the wilful defaulters and accordingly, the first circular on wilful defaulters was issued on February 20, 1999. Subsequently, the Standing Committee on Finance on Financial Institutions in its 8th Report dated 20/12/2000 made various

4 (2017) 10 SCC 1

recommendations pertaining to the cases of wilful defaulters.

With a view to examining recommendations of the committee, a Working Group on Wilful Defaulters (WGWD), headed by the then Chairman IBA was constituted by the RBI in 2001 and WGWD made several recommendations which included the following recommendation:

> "... The debarment of borrowers/promoters from institutional finance might be made for an initial period of 5 years and which could be reviewed thereafter in the light of the experience gained."

The recommendations of WGWD were further examined by an in house Working Group constituted by the Reserve Bank and thereafter, the accepted recommendations were included in the circular and RBI vide circular dated May 30, 2002 had advised the banks and financial institutions as under:

> *"No additional facilities should be granted by any bank / FI to the listed wilful defaulters. In addition, the entrepreneurs / promoters of companies where banks / Fls have identified siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from the scheduled commercial banks, Development Financial Institutions, Government owned NBFCs, investment institutions etc. for floating new ventures for a period of 5 years from the date the name of the wilful defaulter is published in the list of wilful defaulters by the RBI."*

16. In the wake of the aforesaid submissions, since we are called upon to determine the imposition of the penal measures by the Circular of RBI on wilful defaulter, we deem it appropriate to highlight its features.

The Master Circular on wilful defaulter, in its applicability to all Scheduled Commercial Banks (excluding RRBs) and All

India Notified Financial Institutions has set out it's purpose as below :-

> "To put in place a system to disseminate credit information pertaining to wilful defaulters for cautioning banks and financial institution so as to insure that further bank finance is not made available to them".

17. Since the circular is in form of guidelines on wilful defaulters, wilful default is defined 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, deliberate and calculated"

In addition to wilful default, the circular has defined diversion of funds as contemplated in clause (b) of clause 21.3 which include various situations like utilization of short term capital for long term purpose not in conformity with the terms

of sanction, transferring borrowed funds to subsidiaries/group companies, routing of funds through any other bank other than the Lender bank or members of consortium without permission of the lender, investment in other companies by way of acquiring equities etc. Similarly, the term "siphoning of funds' in clause 2.1.3(c) is construed to occur, if any funds borrowed from banks/FIIs are utilized for purposes unrelated to the operation of the borrower, to the detriment of the financial health of the entity or to the lender.

On a person being declared as wilful defaulter, the Maser Circular has set out the penal measures in clause 2.5 which read thus:-

> *"2.5 Penal Measures*
> *The following measures should be initiated by the banks and Fls against the wilful defaulters identified as per the definition indicated at paragraph 2.1.3 above:*
>
> *a. No additional facilities should be granted by any bank/ Fl to the listed wilful defaulters. In addition, such companies (including their entrepreneurs / promoters) where banks / Fls have identified siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from the scheduled commercial banks, Financial Institutions, NBFCs, for floating new ventures for a period of 5 years from the date of removal of their name from the list of wilful defaulters as published/disseminated by RBI/CICs.*
>
> *b. The legal process, wherever warranted, against the borrowers / guarantors and foreclosure for recovery of dues should be initiated expeditiously. The lenders may initiate criminal proceedings against wilful defaulters, wherever necessary.*
>
> *c. Wherever possible, the banks and Fls should adopt a proactive approach for a change of management of the wilfully defaulting borrower unit.*
>
> *d. A covenant in the loan agreements, with the companies to which the banks / Fis have given funded / non-funded credit facility, should be incorporated by the banks / Fls to the effect that the*

borrowing company should not induct on its board person whose name appears in the list of Wilful Defaulters and that in case, such a person is found to be on its board, it would take expeditious and effective steps for removal of the person from its board.

It would be imperative on the part of the banks and Fls to put in place a transparent mechanism for the entire process so that the penal provisions are not misused and the scope of such discretionary powers are kept to the barest minimum. It should also be ensured that a solitary or isolated instance is not made the basis for imposing the penal action."

18. The argument before us revolve around clause (a) which contemplate that where banks/financial institutions have identified siphoning, diversion of funds, misrepresentation, falsification of account and fraudulent transactions, they shall be debarred from institutional finance from commercial banks, etc. for floating new ventures for a period of five years from the date of removal of their name from the list of wilful defaulters, as published by the RBI. It is the submission of Mr.Nankani that in peculiar circumstances, when there is a possibility of settlement of the account by way of compromise and once such compromise is accepted by the lender bank, and the name of the borrower is removed from the wilful defaulter's list, why should it continue with the restriction of not being entitled to avail any facility from scheduled commercial bank/financial institution/NBFC for floating new venture for a period of five years from the date of renewal of removing its name from the list of wilful defaulters.

20. Mr.Shenoy has placed before us the copy of the circular dated 30/7/2024 issued by the Reserve Bank of India being captioned as 'Reserve Bank of India', (Treatment of wilful

defaulters and large Defaulters) Directions, 2024 issued in exercise of power conferred under Section 45(l) of the Reserve Bank of India Act, 1934, Section 35A r/w Section 56 of the Banking Regulation Act, 1949, with a primary objective being to provide for a non-discriminatory and transparent procedure having regard to the principles of natural justice for classifying the borrower as 'Wilful defaulter' by the Lenders. The Directions also aim to put in place a system to disseminate credit information about wilful defaulters for cautioning lenders to ensure that further institutional finance is not made available to them.

The Directions of 2024 has defined 'wilful defaulter' and it has set out the mechanism for identification and classification of wilful defaulters. It provide for initiation of criminal proceedings by lenders in form of specific measures to be initiated against wilful defaulters, including publishing of photographs of the person classified and declared as 'wilful defaulter'.

The said Circular continue with the penal measures now substituted in form of clause 5(3)(a), but has modified clause 2.5(a) in the Circular of 2015 to the following effect

> "5(3) Penal and other measures against wilful defaulters
>
> (a) The penal measures mentioned below shall be implemented by the lenders.
>
> (i) No additional credit facility shall be granted by any lender to a wilful defaulter or any entity with which a wilful defaulter is associated.

(ii) The bar on additional credit facility to a wilful defaulter or any entity with which a wilful defaulter is associated shall be effective for a period of one (1) year after the name of wilful defaulter has been removed from the List of Wilful Defaulters (LWD) by the lender.

(iii) No credit facility shall be granted by any lender for floating of new ventures to a wilful defaulter or any entity with which a wilful defaulter is associated for a period of five (5) years after the name of wilful defaulter has been removed from the LWD by the lender.

(iv) Wilful defaulters or any entity with which a wilful defaulter is associated shall not be eligible for restructuring of credit facility. Subsequent to removal of the name of wilful defaulter from the LWD, the wilful defaulter or any entity with which a wilful defaulter is associated shall be eligible for restructuring, subject to the provision contained in para 5(3) (a) (ii) above.

It is pertinent to note that the new circular has therefore, diluted the bar imposed as regards the availability of additional credit facility for period of one year from the removal of his name from the list of wilful defaulters, though bar of availing credit facility for floating new venture is maintained for a period of five years.

However, the said Circular has included a provision for "Treatment of compromise settlements" which is not a part of the Circular of 2015 and the said provision reads thus:

"11. Treatment of Compromise Settlements

(1) Any account included in LWD, where the lender/ ARC has entered into a compromise settlement with the borrower, shall be removed from the LWD only when the borrower has fully paid the compromise amount.

(2) Till such time as only part payment is made, name of the borrower shall not be removed from the LWD even if the outstanding amount becomes less than the threshold of 725 lakh or as notified by Reserve Bank of India from time to time.

(3) The compromise settlement with the wilful defaulter shall be in terms of the board approved policy of the lender/ARC. Such policy

shall include guidelines on staff accountability examination, reporting of the compromise/ settlement to the board, higher upfront payment if any, etc.

(4) The compromise settlement shall be without prejudice to the continuation of criminal proceedings against the wilful defaulter."

21. The above clause will reveal that when the lender has entered into the compromise settlement with the borrower, any account included in the wilful defaulter's list shall be removed when the borrower has fully paid the compromise amount, but if only part payment is made, the name of the borrower shall not be removed even if the outstanding amount is less than Rs.25 lakhs. By virtue of Clause 4, it is made clear that the Compromise Settlement shall be without prejudice to continuation of the criminal proceedings against the wilful defaulters.

We therefore, find that the new policy of Reserve Bank take into consideration the effect of settlement and upon such settlement being effected, the name of the borrower is removed form the wilful defaulter's list.

22. We also have before us the Reserve Bank of India "Commercial Banks" treatment of wilful defaulter and large Defaulters (Directions) 2025, where the treatment of Compromise Settlement is continued.

Apart from this, there is also a clause included in the new policy for treatment of accounts where resolution is done under Insolvency and Bankruptcy Code (IBC) Resolution framework directions issued by the RBI and it provide that in case where

the account which is included in the list of Wilful defaulters, and has subsequently undergone liquidation, or where the resolution either under IBC or under the RBI Directions 2025, results in change of management and control of entity, the name of such Borrower or Guarantor classified as 'Wilful defaulter' shall be removed from the list after implementation of the Resolution Plan under IBC or RBI Directions 2025.

23. Before the aforesaid policy was revamped by RBI in the year 2024-2025, certain queries received response in form of FAQ by the RBI with regards to the Circular of 8/6/2023 on 'frame work' for Compromise Settlement and Technical Write-offs' and the first query which was answered highlighted thus :-

> **"1. Is it true that the Reserve Bank, vide the above circular, has introduced a new clause permitting lenders to enter into compromise settlement with borrowers classified as fraud or wilful defaulter?**
>
> No. The said provision enabling banks to enter into compromise settlement in respect of borrowers categorised as fraud or wilful defaulter is not a new regulatory instruction and has been the settled regulatory stance for more than 15 years. This enabler is already available to banks as per the extant instructions, as given under:
>
> > i. RBI had advised IBA vide letter dated May 10, 2007 that, "(i) banks may enter into compromise settlement with wilful defaulters/ fraudulent borrowers without prejudice to the criminal proceeding underway against such borrowers; (ii) All such cases of compromise settlements should be vetted by Management Committee/ Board of banks."
> >
> > ii. Master Circular on Wilful Defaulters dated July 1, 2015 envisages lenders agreeing to compromise settlement with borrowers classified as wilful defaulters and states that such cases need not be reported to Credit Information Companies provided inter alia that, "the borrower has fully paid the compromised amount."

> iii. Master Directions on Frauds dated July 1, 2016 provides for compromise settlement with borrowers classified as fraud, subject to the condition that, "No compromise settlement involving a fraudulent borrower is allowed unless the conditions stipulate that the criminal complaint will be continued."

24. The second question whether the RBI had followed the penal measures applicable to borrowers classified as wilful defaulters or fraud, it has clarified that the penal measures shall continue to apply.

In response to the query as to what are the key objectives which the Circular seek to achieve, the RBI has clarified thus:-

> "The circular is intended to achieve the following objectives:
>
> i. It rationalises the existing regulatory guidance to banks on compromise settlements, consolidating various instructions issued over the years. It also tightens some of the related provisions and ensures greater transparency.
>
> ii. By providing a clear regulatory framework, it enables other regulated entities, particularly cooperative banks, to undertake compromise settlements as part of the normal resolution efforts.
>
> iii. It provides clarity on definition of technical write-off and provides a broad guidance on the process to be followed by the regulated entities for technical write-offs, which is a normal banking practice.
>
> iv. As a disincentive to both the lenders and the borrowers, it introduces the concept of cooling period for normal cases of compromise settlement during which the lender undertaking settlement shall not take any fresh exposure on the borrower entity. In case of borrower accounts classified as wilful defaulter or fraud, the debarment to obtain fresh finance, as explained at (2) above, will apply."

25. In the wake of the aforesaid, since we have noted that subsequent to the RBI Master Circular of 1/7/2015, down the

line, Reserve Bank of India itself has given due weightage to compromise/settlement and has permitted removal of the name of the borrower from the list of wilful defaulters.

The petitioners are justified in posing a question that a party who attempt a compromise/settlement by making the payment resulting into closure of its NPA Account in the Bank, when pitched against a party who continue with the default and do not bring in any settlement, then whether or not they fall within two distinct classes.

We find merit in the said submission, as when the Non-Performing Account is settled, we find no justification in continuing with the penalty measures further for a period of five years, unless it is established that the defaulter is guilty of fraud or that he has siphoned off funds, as we find that a wilful default by a borrower, can occur when a borrower defaults in making payment/repayment obligation to the lender and any one or more of the features as set out in the definition of wilful defaulter occurs.

The degree of default would vary in every case, as there may be a simple case where the borrower has the capacity to honor the obligations but still default or the borrower has diverted the funds and defaulted or he has siphoned the funds and defaulted or he has played a fraud and defaulted.

We find that it is unreasonable to treat every such default on par, as once the defaulter had paid the compromise amount, his name is allowed to be deleted from the list of wilful

defaulters, but for making him liable for the embargo in clause 2.5(a), it is necessary to establish siphoning/diversion of funds, misrepresentation, falsification of account and fraudulent transaction, and as clause 2.5(a) impose additional embargo of five years from the date of removal of the name of the borrower/company from the list of wilful defaulters with the presence of element of diversion of funds, misrepresentation, falsification of account, fraudulent transaction being established.

In the recent circulars of 2024 and 2025, we have found distinction being made, as regards the bar on additional credit facility and fresh credit facility for floating new ventures, the former being not allowed for period of one year and the latter for period of five years. However, if for unavoidable circumstances, the borrower is unable to repay the loan, in our opinion, the axe should not fall upon him, debarring him for five years.

26. In the present case, we have noted that the period of five years is likely to expire on 31st May, 2026, and therefore, as far as the petitioners are concerned, we deem it appropriate to read down the imposition of the embargo for a period of five years, though we find that in a suitable case, where it is noted that it is the case of fraud, misrepresentation, falsification of accounts etc, the embargo in Clause 2.5(a) of RBI Circular dated 1st July, 2015, would be pitched against them.

As a result, we declare that as far as the case of the petitioner is concerned, in the wake of the compromise entered by International Mineral Trading Private Limited with the Bank, the restriction imposed for availing additional facility from any Bank/FI, shall not be invoked against the petitioners in the peculiar circumstances stated above.

With the aforesaid clarification, the Writ Petition is disposed.

(R.N. LADDHA,J) (BHARATI DANGRE, J.)

Tilak