

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 23RD DAY OF JULY, 2021

PRESENT

THE HON'BLE SHRI ABHAY S. OKA, CHIEF JUSTICE

AND

THE HON'BLE SHRI JUSTICE M. NAGAPRASANNA

WRIT PETITION NO. 7350 OF 2020 (GM-RES-PIL)

C/W

WRIT PETITION NO. 8674 OF 2020 (GM-RES-PIL)

IN W.P. NO. 7350 OF 2020

BETWEEN:

1. Sri K R Narasimha Murty
and others

. . . Petitioners

(By Sri Venkatesh Dalwai, Advocate)

And:

1. The Secretary
Ministry of Co-operative Societies
and others

. . . Respondents

(By Shri Sushal Tiwari, Advocate for applicant on I.A.No.12/2020;
Shri V. Sreenidhi, AGA for R-1 & R-3 to R-6;
Shri Manmohan P.N., Special Public Prosecutor for R-12;
Shri R.V.S. Naik, Senior Advocate a/w Shri V. Vinay Giri,
Advocate for R-2 and R-10;

Shri Rajesh S.V., Advocate for intervenors;
 Shri A.M. Vijay, Advocate for intervenors;
 Shri Madhukar Deshpande, Advocate for R-11;
 Shri Abhinav R, Advocate for impleading applicant on
 I.A.No.7/2020;
 Shri S.P.Shankar, Senior Advocate a/w Shri B.V. Malla Reddy,
 Advocate for impleading applicant on I.A.No.11/2020;
 R-7 and R-8 are served;
 Shri Halesha R.G., Advocate for impleading applicant on
 I.A.No.13/2020;
 Shri Shyam Prasad, Administrator)

This Writ Petition is filed under Articles 226 and 227 of the Constitution of India praying to issue a writ in the nature of mandamus by constituting a team of Auditors to conduct Forensic Audit of accounts and all transactions of Respondent No.7 from the year 2010 till 31.12.2020 at the earliest and etc.

IN W.P. NO. 8674 OF 2020

BETWEEN:

1. Smt. M.N. Kamalamma and others
 . . . Petitioners

(By Shri Satyanand B.S., Advocate)

AND:

1 . The Principal Secretary
 Ministry of Co-operative Societies
 and others
 . . . Respondents

(By Shri V. Sreenidhi, AGA for R-1, R-2, R-4 to R-6 & R-10;
 Shri R.V.S. Naik, Senior Advocate a/w Shri V. Vinay Giri,
 Advocate for R-3;
 Smt. Vani H, Advocate for R-7)

This Writ Petition is filed under Article 226 and 227 of the Constitution of India praying to issue a writ in the nature of mandamus to constitute a Special Investigation Team headed by High Ranking Officer to investigate the role of every person involved or connected to Respondent No.8 Society both by Respondent No.2 and by Respondent Nos.5, 6 and 9 being monitored by this Court and submit reports to this Court and etc.

These writ petitions, having been heard and reserved for issue of interim directions, coming on for pronouncement of order, this day, the **Chief Justice** pronounced the following:

ORDER

By this order, we are dealing with the issue of powers which can be conferred on the Court appointed Administrator of Sri Guru Sarvabouma Souharda Credit Co-operative Limited (for short "the Credit Co-operative").

2. Writ Petition No.7350/2020 has been filed in public interest for espousing the cause of the investors of Sri Guru Raghavendra Sahakara Bank Niyamitha (for short "the said Co-operative Bank").

3. Writ Petition No.8674/2020 is also filed in public interest for espousing the cause of the investors of the said Credit Co-operative. The said Credit Co-operative has been duly registered under Section 4 of the Karnataka Souhardha Sahakari Act, 1997

(for short “the said Act of 1997”). Various allegations have been made about several financial irregularities, acts of misappropriation, acts of embezzlement of funds and creation of fictitious accounts to the extent of 500.00 Crores on the date of filing of the petition in relation to the said Credit Co-operative. It is pointed out that the said Credit Co-operative has invested an amount of about Rs.235.00 Crores in the said Co-operative Bank. In respect of the said Credit Co-operative, by exercising the powers under Section 5 (1) of the Karnataka Protection of Interest of Depositors in Financial Establishments Act, 2004 (for short “the said Act of 2004”), the State Government has appointed the Competent Authority. The provisions of the said Act of 2004 have been applied to the said Credit Co-operative. In writ petition No.8674/2020, a prayer is made for issue of writ of mandamus directing the respondents to ensure that the amount of about Rs.235.00 Crores is recovered from the said Co-operative Bank. There are various prayers made including the prayer for revival of the said Credit Co-operative. There is also a prayer for challenging the appointment of the Competent Authority under the said Act of 2004 in respect of the said Credit Co-operative. It is pointed out that by passing an order, the Competent Authority

under the said Act of 2004 has virtually ordered closure of the functioning of the said Credit Co-operative.

4. There are various orders passed by this Court from time to time. We may note here that in exercise of powers under Section 38-A of the said Act of 1997, an appointment of a Special Officer was made. However, as provided in sub-section (1) of Section 38-A of the said Act of 1997, the appointment of the Special Officer has come to an end on expiry of the period of six months. As far as the appointment of the Administrator of the Credit Co-operative is concerned, the order dated 26th February 2021 passed by this Court is relevant.

5. Paragraphs No.5 to 13 of the said order read thus:

“5. The question we considering by passing this order is the issue of appointment of an Administrator of the said Credit Co-operative in the context of the fact that the functioning of the said Credit Co-operative has virtually come to a standstill.

6. We must note here that by exercising power under Section 38-A of the said Act of 1997, a Special Officer was appointed. As provided in sub-section (1) of Section 38-A of the said Act of 1997, the term

of the said officer has come to an end on expiry of the period of six months.

7. It is necessary to make a reference to various orders passed from time to time which are relevant for consideration today.

8. Paragraph 3 of the order dated 4th December 2020 makes a note that as the members of the Board of Directors of the said Credit Co-operative have been disqualified, the business of the eighth respondent has come to a stand still. The said order records a *prima facie* finding that the Special Officer appointed under Section 38-A of the said Act of 1997 has no power to conduct the business of the eighth respondent. It is also recorded in the said order that it is doubtful whether an Administrator can be appointed in exercise of the powers under Section 38 of the said Act of 1997. It is the said order which records that as on that day, there is no authority which can look after the management and day-to-day activities of the eighth respondent. Therefore, the Court noted that one possible solution is that in exercise of powers under Article 226 of the Constitution of India, a retired Senior Bank Official can be appointed as an Administrator. The order passed by the Court also records that the offices of the Credit Co-operative are not functioning. In fact, a

grievance was made across the Bar that the Fixed Deposits of the investors in the said Credit Co-operative which are already matured cannot be renewed as a result of the closure of the functioning of the said Credit Co-operative.

9. At this stage, it is necessary to consider the relevant provisions of the said Act of 1997. As stated earlier, at one stage, Special Officer was appointed in exercise of power under Section 38-A. The said provision reads thus:

“38-A. Appointment of Special Officer:-

(1) Where the activities of a co-operative are not being conducted in accordance of the provisions of this Act, the Rules or the bye-laws made thereunder as a result of the directors of the board falling short of the required number to form a quorum due to disqualification, resignation or death or removal of a director or where all the directors of a co-operative have incurred any disqualification under sub-section (2) of Section 25 or where all the directors have tendered resignation, the Federal co-operative may be order appoint a Special Officer for such co-operative, for such period not exceeding six months.

(2) Before making an order under subsection (1), it shall not be necessary for the Federal co-operative to give any co-operative or persons likely to be affected by such order, an opportunity to state its or their objection, if any.

(3) The Special Officer shall inform the co-operative election commission about conducting election to fill up the vacant seats on the board and the Election Commission shall conduct election for the remaining term of the vacant seats.

(4) As soon as the elections are held and the number of directors to form the quorum are available, the Special Officer shall handover the management to the board and the office of the Special Officer shall be deemed to have been vacated.”

10. On a plain reading of the said provision, it appears that the appointment of a Special Officer can be made only for a maximum period of six months. There is no provision in the said Act of 1997 which specifically empowers the Special Officer to exercise the powers of the Board of Directors of the Credit Co-operative.

11. Section 38 in Chapter VI of the said Act of 1997 provides for Supersession or Suspension of the Board of Directors and appointment of an Administrator. However, the second proviso to sub-section (1) of Section 38 of the said Act of 1997 provides that the Board of any such Credit Co-operative shall not be superseded or kept under suspension where there is no Government shareholding or loan or financial assistance or any guarantee by the Government. In this case, there is nothing placed on record to show that there is a Government shareholding in the said Credit Co-operative or that the Credit Co-operative has received loan or financial assistance or any guarantee from the State Government. In fact, this is not the case made out by the State Government. Therefore, it will not be possible to exercise powers under Section 38 of the said Act of 1997 to appoint an Administrator.

12. The State Government has appointed a Competent Authority in accordance with sub-section (1) of Section 5 of the said Act of 2004. However, the powers, duties and functions of the Competent Authority under the said Act of 2004 are well defined. The Competent Authority has not been empowered to look after the day-to-day functioning of the Credit

Co-operative. It is also brought on record that a very large amount has been invested by the said Credit Co-operative with Sri Guru Raghavendra Sahakara Bank Niyamitha. The said amount is approximately of Rs.235.00 Crores. In view of the orders passed by the Reserve Bank of India (RBI) under the provisions of the Banking Regulations Act, 1949, even the said amount of Fixed Deposit cannot be encashed.

13. The eighth respondent-Credit Co-operative has its own staff and office premises. There is no one who can effectively deal with the investors. Therefore, the question is whether a retired Senior Bank Official can be appointed as an Administrator who will ensure that the day-to-day activities of the Credit Co-operative will continue.”

(Underline supplied)

Thereafter, this Court considered certain decisions of the Apex Court. Paragraphs No.16 to 19 of the said order read thus:

“16. It can be said that there is a lacuna in the provision of the said Act of 1997 as there are no provisions for dealing with the situation in which the said Credit Co-operative is placed today. It is for the Legislature to consider whether suitable amendments can be made in the provisions of the

said Act of 1997. However, as noted earlier, the investors of the said Credit Co-operative are the sufferers as their investments in the said Credit Co-operative are completely locked in view of the fact that the amounts invested by them have been transferred by the said Credit Co-operative to the seventh respondent Co-Operative Bank. There is no effective protection to the investors of the Credit Co-operative. There are not in a position even to renew their Fixed Deposits. Their rights are in jeopardy. As held by the Apex Court in the case of ***Benedict Denis Kinny*** (Supra), the power under Article 226 of the Constitution of India must be used to remedy injustice in a case like this. Therefore, it is a fit case where this Court should exercise its jurisdiction under Article 226 of the Constitution of India by appointing a retired Senior Bank Official as an Administrator.

17. As observed earlier, the issue is of life or death for the investors as they are not likely to get back their investments in near future. We had, therefore, requested the learned counsel appearing for RBI to suggest names of two Retired Senior Officials of a Nationalized Bank. Accordingly, along with a memo dated 24th February 2021, two names have been placed on record. Out of the said two names, we propose to appoint Shri K.S. Shyam

Prasad, Retired Deputy General Manager, Canara Bank as an Administrator. As he will be doing a full time job, the State Government will have to pass an order of appointment by incorporating the remuneration and perquisites admissible to the Administrator. Normally, the remuneration shall be equivalent to the last drawn pay of the Special Officer minus pension, if any.

18. The question is what powers can be exercised by the retired Bank Officer who is appointed as the Administrator. To enable the Court to decide the said question, we propose to direct the Administrator to take charge of the Credit Co-operative and to examine the records of the said Credit Co-operative. After examining the records and after making a study of the situation at the grass root level, the Administrator will submit a report to this Court stating what according to him are the immediate steps required to be taken for restoring the functioning of the said Credit Co-operative. Only after he submits a report to this Court and after hearing him, this Court will pass an elaborate order regarding the powers which can be exercised by the Administrator.

19. We, accordingly, direct the State Government to issue an order of appointment of Shri K.S. Shyam Prasad, a Retired Deputy General Manager, Canara

Bank as the Administrator of the said Credit co-operative. As directed earlier, the State Government shall specify the conditions of service including the remuneration payable to Shri K.S. Shyam Prasad.”

(Underline supplied)

Now, the Administrator Shri K.S. Shyam Prasad has assumed charge of his post.

6. The Administrator has submitted detailed reports to this Court. Before we examine the issue of the powers which can be conferred on the Administrator, a brief reference to the reports submitted by Shri K.S. Shyam Prasad will be necessary. The first report of the Administrator is of 9th April 2021. He has mentioned the status of the accounts of the said Credit Co-operative and various fraudulent transactions. He has also dealt with the revival prospects of the said Credit Co-operative. He has mentioned that an amount of Rs.90.00 Crores which belongs to the depositors of said Credit Co-operative has been deposited with the said Co-operative Bank. It is stated that the said amount has been credited to various NPA accounts of the said Co-operative Bank. It is further stated that a sum of Rs.96.00 Crores has been fraudulently diverted from the Credit Co-operative for the use by

non-members. The Administrator has sought several powers from the Court. The first power is to get re-audit done from the date of registration of the said Credit Co-operative and to follow up the issue of statutory audit which is pending from 2019-20. He has also sought power to follow up the loan recovery and to issue provisional certificates to the borrowers on payment of full and final settlement of their mortgage loans, pending re-audit of the account books. He also sought conferment of power to issue notice to the defaulters, a power to close the loans availed against the deposits and transfer surplus amount to the savings accounts of the borrowers. He has also sought powers to draw money for making payment of arrears of salary to the staff of the said Credit Co-operative as well as to meet the expenses such as electricity charges, water charges, stationary and other miscellaneous expenses. Another important power which the Administrator has sought to is to renew the Fixed Deposits.

7. The Administrator is also seeking a direction against the Enforcement Directorate (for short "ED") to allow the ED to use the office of the Credit Co-operative which has been attached by it. It is pointed out by the Administrator that at present, the office

of the said Credit Co-operative is functioning in a rented premises, Therefore, there is unnecessary burden on the said Credit Co-operative of payment of monthly rent of Rs.18,900/-. He has sought a prayer for issue of a direction to the said Co-operative Bank to publish their audited financial statements only after reconciliation of its accounts with the said Credit Co-operative.

8. The Administrator has submitted one more report on 22nd June 2021. In the said report, he has dealt with the application made by one Shri Sreepathi Herele P for repayment of loan amount. He has stated that this borrower had availed housing loan from the said Credit Co-operative and that the liability of the said borrower as on 5th March 2020 was in the sum of Rs.29,56,921/-. He recommended that a sum of Rs.29,56,921/- with further interest should be accepted from the borrower. He has suggested that an indemnity bond should be taken from the borrower and his wife who is the co-obligant. The Administrator has filed on record a copy of Deed of Simple Mortgage dated 29th October 2016 executed by the said borrower by way of security.

9. Another report dated 29th June 2021 submitted by the Administrator Shri K.S. Shyam Prasad is placed on record by the learned Additional Government Advocate. He has laid emphasis in the said report on the said Co-operative Bank making reconciliation of the accounts with the said Credit Co-operative.

10. We have heard the learned counsel representing parties in both the petitions on the issue of powers to be conferred on the Administrator appointed under the orders of this Court. On this aspect, we will have to deal with several issues.

11. The first issue is whether the Administrator can be allowed to renew the Fixed Deposits with the said Credit Co-operative. This issue is a very serious issue inasmuch as if the Administrator is permitted to renew the Fixed Deposits, he will be incurring a liability on behalf of the said Credit Co-operative of paying the principal amount with interest. Today, practically no money is available with the credit Co-operative to pay the aforesaid amounts, as the amounts invested in the said Co-operative in the form of Fixed Deposit have been in turn transferred to the said Co-operative Bank and the Fixed Deposits in the said Co-operative Bank are under the orders of attachment. Only some

amount is available in the account opened by the Competent Authority appointed under the said Act of 2004. The office of the Credit Co-operative has been attached by ED. Today, even if a Fixed Deposit is renewed, it is impossible for the Credit Co-operative to pay interest thereon. It is in this context, the issue is, whether by a judicial order, this Court can confer on the Administrator a power to renew the Fixed Deposits of the investors. Apart from the fact that the Court appointed Administrator cannot create new liabilities, the act of renewal of the Fixed Deposits may give a false hope to the investors. Therefore, we propose to permit the Administrator to renew the Fixed Deposits of the investors on the requisition in writing submitted by each investor stating that he or she is fully aware that even if the Fixed Deposit is renewed, there is no guarantee that the principal amount and interest will be paid by the said Credit Co-operative to him/her. The investors must also agree that he/she will be entitled to the principal amount and/or interest only if ordered by the Special Court under the said Act of 2004 and only to the extent allowed by the said Court. Moreover, the investor will have to give undertaking not to make any personal

claim against the Administrator on the basis of the renewed Fixed Deposits.

12. As regards the salary of the staff and expenses incurred by the Administrator, we propose to direct the Administrator to submit a report in writing to the Competent Authority under the said Act of 2004 along with the documents. The said report will set out the details such as the amounts of arrears of salary of the staff, arrears of electricity bill etc., which are due and payable till the date of submitting the report. Along with the said report, the Administrator shall submit a broad estimate of the amount required per month for payment of salary to the staff members, for meeting the other outgoings such as, electricity bills, rent, sundry expenses etc. The Competent Authority shall apply to the Special Court under the said Act of 2004 for seeking necessary directions. The Administrator, on 30th June, 2021 has stated that a sum of Rs.2,77,000/- is payable towards the arrears of salary of the staff and a sum of Rs.1,89,000/- is payable by way of arrears rent of the office premises. Moreover, certain amount is due and payable by way of water and sanitary charges, electricity arrears and Wi-Fi connection charges.

13. As regards the acceptance of the repayment of the loan amount, we propose to permit the Administrator to accept the repayment of the loan amount and close the loan account by executing necessary documents and by giving a discharge certificate. However, in each case, he will have to seek a leave of the Court before he does that. As regards the borrower Shri Sreepathi Herele P, we propose to permit the Administrator to accept the entire amount due and payable by the borrower and close the loan account subject to the conditions as suggested by the Administrator in his report. The loan amount shall be deposited in the account of the Competent Authority under the said Act of 2004. We permit the Administrator to execute on behalf of the Credit Co-operative, necessary registered document for cancellation of simple mortgage executed by the said borrower.

14. For initiating recovery proceedings and for drafting of documents, the Administrator is entitled to engage services of Advocates. The Competent Authority will accordingly apply to the Special Court for sanction of ad hoc amount in that behalf.

15. Hence, we hold that Shri K.S. Shyam Prasad, the Administrator of Sri Guru Sarvabouma Souharda Credit Co-operative Limited shall be entitled to exercise the following powers:

- i) To continue day-to-day functioning of the said Credit Co-operative without creating any liability except the liabilities which are permitted under this order;
- ii) The administrator shall be empowered to initiate recovery proceedings against the borrowers of the said Credit Co-operative by issuing notices and by filing appropriate proceedings in accordance with law on behalf of the said Credit Co-operative. For that purpose, the Administrator shall be entitled to engage services of Advocates;
- (iii) In the event, any borrower comes forward to repay the loan amount, after obtaining a specific leave of this Court, the Administrator shall be entitled to accept the amount due and payable from the borrower, execute necessary documents and issue provisional discharge certificate. The amount received from the borrowers shall be credited to the account of the said Credit Co-operative in the name of the Competent Authority under the said Act of 2004;

- (iv) We permit the Administrator to accept the upto date amount due and payable from Shri Sreepathi Herele P, to execute necessary registered document of cancellation of mortgage and to issue discharge certificate subject to compliance with the conditions as suggested by the Administrator in his report. The amount received from the said borrower shall be credited to the account of the Competent Authority under the said Act of 2004;
- (v) On the request in writing made by any member of the Credit Co-operative holding Fixed Deposits for renewal of the Fixed Deposits, the Administrator is permitted to renew the Fixed Deposits provided the person holding the Fixed Deposit, gives a written undertaking stating that he or she is fully aware that even if the Fixed Deposit is renewed, there is no guarantee that the principal amount and interest will be paid by the said Credit Co-operative. The investor shall also give an undertaking that he will be entitled to receive the principal amount of Fixed Deposit and interest only to the extent permitted under the orders of the Special Court under the said Act of 2004. The investor of the Fixed Deposit will also give an undertaking not to make any personal claim against the Administrator on the basis of the renewal of the Fixed Deposit. Only after such undertakings in writing are given by the investor and after making

due inquiry about the genuineness of the Fixed Deposit receipt, the Administrator shall renew the Fixed Deposits;

- (vi) The Administrator shall submit a report to the Competent Authority under the said Act of 2004 containing details of the amounts payable as on today towards arrears of the salary of the staff, arrears of rent in respect of office premises, arrears of electricity, water and maintenance charges in respect of the office premises, internet charges, sundry expenditures incurred on running of the office. He will also submit an estimate of the amount required per month for meeting the aforesaid expenditure for running the office of the said Credit Co-operative. The Administrator shall also submit an ad hoc estimate of the amount required towards Advocate's fees. As soon as the details are received, the Competent Authority shall be immediately make an application to the Special Court for permitting the Competent Authority to release the aforesaid amounts to the Administrator. The Special Court shall pass an order on the applications/report submitted by the Competent Authority within maximum period of one month from the date of filing of the report/application by the Competent Authority;
- vii) We direct the ED to apply to the Competent Court under the Prevention of Money Laundering Act, 2002, for permitting the said Credit Co-operative to

use its office premises for running its office. If such an application is made, the said Court shall decide the same at the earliest;

- (viii) It will be open for the Administrator to make a requisition for conduct of statutory audit or re-audit of the accounts of Credit Co-operative;
- (ix) We direct that the Administrators of both the Co-operative Bank and the said Credit Co-operative shall hold regular meetings to sort out various issues arising between two entities;
- (x) In the event the Administrator of the Credit Co-operative needs further directions, he will submit a report to the Court through the learned Additional Government Advocate, who will immediately move the Court on the basis of the said report for necessary directions.

The petitions shall be listed on 18th August, 2021 for hearing the parties and for issuing further directions.

**Sd/-
CHIEF JUSTICE**

**Sd/-
JUDGE**

Mr.