

CANARA BANK
v.
P.R.N. UPADHYAYA AND ORS.

AUGUST 25, 1998

[DR. A.S. ANAND, M. SRINIVASAN AND
S. RAJENDRA BABU, JJ.]

Banking Regulation Act, 1949—Section 21, 35—Circulars issued by Reserve Bank of India—Held, Statutory in nature and required to be complied with by the banks.

S.35A—Banking Ombudsman—Appointed by virtue of the scheme framed under the section—Duties—Held, to regulate the working of the banks and to issue directions to carry out the circulars and directions issued by the Reserve Bank of India.

Words & Phrases—Term Loan—Meaning of in the context of banking law and practice.

The appellant-bank sanctioned loans of Rs. 80,000 on 12.1.1980, Rs. 25,000 on 21.2.1986 and Rs. 2,00,000 on 22.2.1991 in favour of respondent no. 3 for construction of strong rooms which were to be taken on lease by the appellant after construction/renovation. In respect of loans granted on 12.1.1980, 21.2.1986 and 22.2.1991, respondent no. 3 executed Demand Promissory Notes undertaking to pay interest at the rate of 5% above the Reserve Bank of India rate of interest with minimum rate of interest @ 14% per annum compounded quarterly, 7.5% above the R.B.I. rate of interest with minimum rate of interest @ 17.5% per annum compounded quarterly and 7.5% above the R.B.I. rate of interest with minimum rate of interest @ 17.5% per annum compounded quarterly, respectively. The two loans granted in the year 1980 and 1986 were, after payment, closed in 1988 and 1989 respectively. Interest in respect of those loans was debited at the contractual rate with quarterly rests. The appellant - bank also debited interest with quarterly rests in respect of the loan of Rs. two lacs and irrespective of the higher contractual rate of interest, the bank debited interest only at the rate of 15% per annum in view of its Head Office Circular no. 379/90 and no. 90/91.

A Respondent nos. 2 to 5 filed a complaint before the Banking Ombudsman in August, 1996 assailing the action of the appellant - bank in charging interest at the contractual - rate with quarterly rests in respect of the loans granted in the year 1980 and 1986 and also for debiting interest with quarterly rests in respect of the loans granted in 1991. The respondents sought a direction from the Banking Ombudsman to the appellant
B - bank to recast the interest debited in all the loan accounts by debiting interest at simple rate and to adjust the excess amount charged by way of higher interest to the loan account granted in 1991 and to pay the balance amount, if any, to the respondents. The contention of the appellant - bank before the Banking Ombudsman was that its action was based on various
C circulars issued by the Reserve Bank of India from time to time including the circulars dated 1.4.1981, 7.3.1986 and 17.5.1994. The Banking Ombudsman relying upon the judgment in *State Bank of Patiala v. Harbans Singh*, [1994] 3 SCC 495 allowed the complaint of respondent nos. 2 to 5 and directed the appellant - bank to recast the two loan accounts for the
D year 1980 and 1986 which stood closed in 1988 and 1989 respectively. The Banking Ombudsman held that (i) the loans granted by banks to their landlords for construction/renovation of premises which the banks take on lease or rent later on, cannot be termed as "Term Loans", and (ii) interest could not be charged by the banks in respect of such loans at quarterly rests and that the appellant bank could only charge simple interest at the
E rate of not more than 15% in respect of the loan granted to a landlord. Against the aforesaid award dated 26.2.1997 made by the Bank Ombudsman the appellant - bank has filed this appeal.

The contention of the appellant - bank was that communications
F dated March 13, 1976, April 1, 1991, April 18, 1991 and March 7, 1986 issued by Reserve Bank of India clearly indicate that the loans advanced by banks to landlords for construction/renovation of premises to be taken by the banks for its use on lease/rent were required to be treated as "Term Loans" and the banks were entitled to charge interest at the minimum rate of 15% per annum compounded with quarterly rests.

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Allowing the appeal, the court

HELD : 1.1. Circulars issued by the Reserve Bank of India under
H Section 21 or 35 of the Banking Regulation Act, 1949 are statutory in nature and are required to be complied with by the banks. [100-D]

1.2. Since, an Ombudsman is appointed by virtue of the scheme framed under Section 35A of the Banking Regulation Act, 1949, the Ombudsman is obliged to comply with the directions/circulars and notifications issued by the Reserve Bank of India under Section 21 or 35 of the Act. He is also obliged to regulate the working of the banks and issue directions to them to carry out the directions and circulars issued by the R.B.I. under Sections 21 and 35 of the Act and ensure their compliance. [103-E]

2. The expression "term loan" is well understood in banking parlance. The expression implies the grant of loan for a fixed term. It has no relevance with the purpose for which loan is granted. [100-F]

Tannan's Banking Law & Practice in India, 18th Edition referred to.

3. There have been more than a dozen circulars/notifications/directions issued by the Reserve Bank of India, which deal with the subject of rate of interest to be charged from the landlords loanees and the manner of its calculation. A critical examination and application of those circulars by the Ombudsman was necessary to decide the complaint filed by the respondents against the appellant - bank. The impugned award having been made ignoring various circulars/directions issued by the Reserve Bank of India, the same cannot be sustained. The impugned award dated 26.2.1977 is therefore set aside and the complaint is remitted to the Ombudsman for its fresh disposal in the light of the circulars/directions issued by the Reserve Bank of India. [103-D-F]

State Bank of Patiala v. Harbans Singh, [1994] 3 SCC 495, distinguished.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 4286 of 1998 Etc.

From the Judgment and Order dated 26.2.97 of the Banking Ombudsman, at Hyderabad in Andhra Pradesh in C.A. No. 124 of 1996.

V.R. Reddy, Pradeep Dewan, Ms. Praveena Gautam, Pramod B. Aggarwala for the Appellant.

Harish N. Salve, Pradeep S. Parihar, Kuldeep S. Parihar and H.S. Parihar for the Respondent for R.B.I.

A A.S. Nambiar and G. Prabhakar for the Respondent Nos. 1-4 in C.A. No. 4286/98 and 1-2 in C.A. No. 4287/98.

The Judgment of the Court was delivered by

B DR. ANAND, J. Leave granted.

C This appeal is directed against an award made by the Banking Ombudsman, Hyderabad, (appointed under the Banking Ombudsman Scheme, 1995) dated 26.2.1997, in a complaint filed by the respondents against the appellant bank. The appeal arises in the following circumstances:

D On 12.1.1980, the appellant bank sanctioned a loan of Rs. 80,000 in favour of respondent no.3 for construction of a strong room. A further loan of Rs. 25,000 was granted to respondent no. 3 on 21.2.1986 to meet part of the construction cost of the premises which were to be taken on lease by the appellant. On 22.2.1991, an additional loan of Rs. 2,00,000 was granted by the appellant bank to respondent no.3 to construct a bigger strong room. The entire premises, after the construction/renovation, were taken on lease by the appellant bank. In respect of the loan granted on 12.1.1980, respondent no.3 executed a Demand Promissory Note undertaking to pay interest at the rate of 5% above the Reserve Bank of India rate of interest with minimum rate of interest @ 14% per annum compounded quarterly. So far as the loan granted on 21.2.1986 is concerned, respondent no.3 executed a Demand Promissory Note, undertaking to pay interest at the rate of 7.5% above the Reserve Bank of India rate of interest with minimum rate of interest @ 17.5% per annum compounded quarterly. A similar Demand Promissory Note was also executed by respondent no.3 in respect of the loan dated 22.2.1991 undertaking to pay interest at the rate of 7.5% above the Reserve Bank of India rate of interest with minimum rate of interest @ 17.5% per annum compounded quarterly. The two loans granted in the year 1980 and 1986 were, after repayment, closed in 1988 and 1989 respectively. Interest in respect of those loans had been debited at the contractual rate with quarterly rests. The appellant bank also debited interest with quarterly rests in respect of the loan of Rs. Two lacs and irrespective of the higher contractual rate of interest, the bank debited interest only at the rate of 15% per annum in view of its Head Office Circular No. 379/90 and No. 90/91.

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Respondent Nos. 2 to 5 filed a complaint before the Banking Ombudsman in August, 1996 assailing the action of the appellant bank in charging interest at the contractual rate with quarterly rests in respect of the loans granted in the year 1980 and 1986 and also for debiting interest with quarterly rests in respect of the loan granted in 1991. The respondents requested the Banking Ombudsman for a direction to the appellant bank to recast the interest debited in all the loan accounts by debiting interest at *Simple Rate* and to adjust the excess amount charged by way of higher interest to the loan account granted in 1991 and to pay the balance amount, if any, to the respondents. The complaint was entertained by the learned Ombudsman and notice was issued to the appellant who resisted the application on various grounds. The appellant justified its action on the basis of various circulars issued by the Reserve Bank of India from time to time including the circulars dated 01.04.1981, 07.03.1986 and 17.5.1994.

Relying upon the judgment of this Court in *State Bank of Patiala v. Harbans Singh*, [1994] 3 SCC 495, the learned Ombudsman allowed the complaint of respondent nos. 2 to 5 and directed the appellant bank to recast the two loan accounts of the year 1980 and 1986 which stood closed in 1988 and 1989 respectively. The learned Ombudsman, after referring to the circular dated April 18, 1991 (Circular seems to be of April 1, 1991) and certain other circulars opined that the loans granted by banks to their landlords for construction/renovation of premises which the banks take on lease or rent later on, cannot be termed as "term loans". The learned Ombudsman also opined, on the basis of the judgment in *Harbans Singh's* case (*supra*), that interest could not be charged by the banks in respect of such loans at *quarterly rests* and that the appellant bank could only charge simple interest at the rate of not more than 15% in respect of the loan granted to a landlord.

The learned Ombudsman with a view to give his Award had framed the following five issues:

1. Whether the grievance of the complainant regarding mode of calculation of simple interest and appropriation of credits received can be considered:

2. Whether Limitation Act is applicable;

3. Whether the reopening of the charging of interest can be entertained keeping in view Section 21 A of the Banking Regulation Act;

4. Whether the bank is justified to charge interest over and above the contractual rate; AND

5. Charging of interest on quarterly compounding basis.

Since, there is no controversy raised before us as regards the first three issues, we are relieved of the necessity to deal with those three issues.

Dealing with issue No. 4, the learned Ombudsman opined:

"As regards the fourth point that the bank had charged interest to the loan accounts in excess of the contracted rate and that too at quarterly rests. It has failed to substantiate and establish that the interest charged in the accounts was in conformity with the Reserve Bank of India directions more specifically the R.B.I. Circular No. DBOD.NO.BL.B.C.60/22.01.0003/94 dated 17.5.1994. As per this circular it is clear that the bank can charge interest only at a rate contracted at the time of sanction of the loan and the bank is not entitled to vary the rate of interest when ever there is a change in the interest rate for term loans. I therefore, hold this point in favour of the complainant."

While dealing with issue no. 5, the learned Ombudsman observed :

"As regards the fifth issue it is observed that charging of interest at quarterly rests was also in violation of the principles laid down by the Supreme Court in the case of *State Bank of Patiala v. Harbans Singh* Civil Appeal No. 1690 of (1994) arising out of SLP (C) No. 14276 of (1993). The Honourable Supreme Court while dealing with the question of bank's right to charge interest on quarterly rest held that:

"In the light of directions given by the Reserve Bank of India which the commercial banks are bound to follow and the bank itself adopted that policy and reduced the rate of interest, the liability to pay quarterly rests is obviously illegal. The trial court and the District Court, therefore, are quite right in limiting the

liability of the respondent only to pay simple interest on the loan advanced by the Bank at 15% per annum without quarterly rests."

The above decision is equally applicable to the facts of the present case and the point under consideration. In view of the above decision of the Honourable Supreme Court I have no hesitation to hold that the bank is not entitled to charge compound rate of interest on quarterly rests and as such the action of the bank is held to be in violation of the law laid down by the Supreme Court. Consequently I hold this point also in favour of the complainant."

Mr. V.R. Reddy, learned Senior counsel, appearing for the appellant bank and Mr. Harish Salve, learned Senior counsel, appearing for the Reserve Bank of India assailed the aforesaid findings of the learned Ombudsman. Learned counsel submitted that the Reserve Bank of India had in its letter dated 13.3.1976 clearly provided that scheduled banks could charge interest with quarterly rests. Emphasis in this behalf was particularly laid on the following excerpt from the communication of the Reserve Bank of India dated March 13, 1976:

"1 (ii) no scheduled commercial bank incorporated in India and having aggregate demand and time liabilities of Rs. 25 crores or about but less than Rs. 50 crores as on the 12th March, 1976 or at any time thereafter, shall charge interest on loans/advances/cash credits/overdrafts or any other financial accommodation made or provided by it or renewed by it, or discount usance bills at a rate, in either case, higher than 17.5% p.a. interest shall be charged with *quarterly rests*."

Learned counsel also referred to the direction issued by the Reserve Bank of India dated March 7, 1976 and submitted that according to that communication, advances granted by banks to landlords for purpose of construction/renovation of premises for its use were required to be treated as "Term Loans" and charged interest accordingly and that this position had been further clarified by the Reserve Bank of India through its circular dated April 18, 1991, wherein it was stated that the minimum rate of interest on loans advanced to landlords for the premises leased out to the banks should be at the rate of 15% per annum. It was submitted that

- A communication dated April 18, 1991 read with the earlier communication of March 13, 1976, April 1, 1991 and March 7, 1986 clearly indicated that in the case of loan advanced to the landlord for construction/renovation of premises to be taken by the banks on lease/rent, the banks were entitled to charge interest at the minimum rate of 15% per annum compounded with quarterly rests. Learned counsel also submitted that insofar as the judgment in *State Bank of Patiala v. Harbans Singh*, [1994] 3 SCC 495, is concerned, that did not refer to, much less consider and discuss, various circulars issued by the Reserve Bank of India under Section 21 or Section 35 of the Banking Regulation Act, 1949 and as such that judgment could not be treated to have laid down the law after considering various circulars issued by the Reserve Bank of India, which have a statutory flavour.

- That the circulars issued by the Reserve Bank of India under Section 21 or 35 of the Banking Regulation Act, 1949 are statutory in nature and are required to be complied with by the banks is not in any doubt. An Ombudsman appointed under the Scheme is obliged to regulate the working of the banks and issue directions to them to carry out the directions and circulars issued by the Reserve Bank of India under Section 21 or 35 of the Act. The view taken by the learned Ombudsman to the effect that the loans granted by the banks to their landlords for construction/renovation of premises which are taken on lease or rent by the banks cannot be termed as "term loans", as in the words of the learned Ombudsman "only those loans which are taken for commercial purposes can be construed to be term loans", is clearly erroneous and does not appeal to us.

- The expression "term loan" is well understood in banking parlance. The expression implies the grant of loan for a *fixed term*. It has no relevance with the purpose for which loan is granted. Where the term for repayment is long, the loan is called "long term loan" and where the term exceeds one year but not five to seven years, it is commonly known as "medium term loan". According to *Tannan's Banking Law & Practice in India*, 18th Edition the expression loan is defined as follows:-

- "Loans - When a banker makes an advance in a lump sum the whole of which is withdrawn and is supposed to be repaid generally wholly at one time is called a loan. If the customer repays the same either wholly or partially and wishes to have accommodation sub-

sequently, the latter will be treated as a separate transaction to be entered into if the bank agrees to do so and subject to such terms as the bank may like to impose. Thus the bank does not suffer any loss of interest as a result of carrying excessive cash which is necessary in the case of cash credits and overdrafts. Loan accounts are said to have a lower operating cost than cash credits and overdrafts because of the larger number of operations in the case of the latter as compared to the former and consequently a lower rate of interest on loans appears to be justifiable than in the case of overdrafts and cash credits.

The expression *term loan* has been defined in the same book as follows:-

"*Term Loan* - Where a loan is granted for a fixed period exceeding one year and is repayable according to a schedule of repayment, as against on demand and at a time, it is known as a 'term loan'. Where the period exceeds one year but not, say 5 to 7 years, it is commonly known as a medium-term loan; a loan with longer repayment schedule is known as long-term loan. A term loan is generally granted for fixed capital requirements, although such loans for working capital are not unknown, and are supposed to be repaid out of future earnings of the fixed assets in particular and of the borrower in general. It therefore requires a proper and more sustained appraisal of various factors connected with the proposition than an ordinary commercial demand loan."

Thus, the opinion of the learned Ombudsman to the effect that circulars of the Reserve Bank of India which permitted charge of interest at quarterly rests applies only to "term loans" for "Commercial purposes" and not to the loans given to the landlords for construction/renovation of the premises, does not bear scrutiny. The view expressed by the learned Ombudsman was apparently influenced by the judgment of this Court in *Harbans Singh's* case (supra), which had negatived the plea raised on behalf of the appellant bank in that case that the word *term loan* would include not only the loan advanced for commercial purposes but also such loans as one advanced to the landlords for construction/renovation of the buildings given on lease to the lending bank for their commercial purposes. A careful persual of the judgment in *Harbans Singh's* case (supra), how-

A ever, shows that the Bench was handicapped because various circulars/notifications/directions issued by the Reserve Bank of India under Sections 21 and 35 of the Act dealing with the subject were not brought to the notice of the Bench. This is explicit from the following observation of the Bench:

B "Though we have given sufficient time and adjourned the case
from time to time to produce all the records, the bank has not
chosen to produce the records; in particular, circular letter of
Reserve Bank of India bearing DBOD NO.DCDC 106/c 168(61-
80) dated 15.09.80 on the subject of minimum lending rates of
C interest in respect of advances to the landlords. Therefore, we are
constrained to proceed on the basis of the material placed by the
appellants and the respondent."

D It was, thus, on account of lack of relevant material before it, that
the Bench opined:

E "In the light of these intrinsic factual material, directions by the
Reserve Bank and circumstances, it is clear that there is no liability
of the landlord, who had taken loan for constructing the premises
and leasing back to the bank for commercial purpose, to pay
interest at more than 15% and *he need not pay interest at quarterly
rest. The letter of RBI dated 13.3.1976 also indicates that the obligation
to pay quarterly rest was not with reference to the loans taken
by the landlords for construction of the premises but for commercial
purpose. The word term loan was used for the commercial purpose
and it did not include the loan advanced to the landlords for
F construction of the buildings. Term loan would mean the loan
advanced for commercial purposes and not the loans given to the
landlords for construction of the buildings to lease back for the use
by the bank itself. It was not so intended would be clear from clause
1(ii) of the letter relied on by the bank (Ex. P-7) as extracted
G earlier. It would indicate that in respect of commercial loans, they
appear to have intended to charge quarterly rest. The Reserve
Bank at nowhere indicated that the term loans given to the
landlords for construction of the buildings to lease back to the
commercial banks should be intended to be charged with interest
H with quarterly rest. On the other hand, they have reduced suffi-*

ciently from time to time even the lending rate of interest in favour of landlords/lessors." (Emphasis supplied) A

The judgement in *Harbans Singh's* case therefore, proceeded on the facts as pleaded by the parties, in the absence of relevant material, which apparently were not brought to the notice of the court. That judgment must, therefore, be considered as confined to the facts of that particular case and not to be an exposition of law based on various circular/directions and notifications issued by the Reserve Bank of India which have statutory force with regard to the meaning of "term loan" or charge of interest from the landlords with quarterly rests. B C

Learned counsel for the parties before us, did not dispute that there have been more than a dozen circulars/notifications/directions issued by the Reserve Bank of India, which deal with the subject of rate of interest to be charged from the landlords loanees and the manner of its calculation. A critical examination and application of those circulars was necessary to decide the complaint filed by the respondents against the appellant bank, which unfortunately the learned Ombudsman did not do. Since, an Ombudsman is appointed by virtue of the Scheme framed under Section 35 A of the Banking Regulation Act, 1949, he is obliged to comply with the directions/circulars and notifications issued by the Reserve Bank of India under Section 35 or 21 of the Act. He is also required to issue directions to Banks, based on those directions/circulars and ensure their compliance. The learned Ombudsman could not have ignored the circulars and directions while dealing with the complaint filed by the respondent. The impugned award having been made ignoring various circulars/directions issued by the Reserve Bank of India, the same cannot be sustained. It is therefore, appropriate that we set aside the impugned award dated 26.2.1997 and remit the complaint to the learned Ombudsman (Hyderabad) for its fresh disposal in the light of the circulars/directions issued by the Reserve Bank of India with regard to charging of rate of interest from the landlord loanees, whose buildings are taken on lease/rent by the concerned bank and calculating the interest at quarterly rests. Accordingly, this appeal succeeds and is allowed. The complaint is remanded to the learned Banking Ombudsman, Hyderabad, for its fresh disposal in the light of the observations made hereinabove. D E F G H

- A Since, we are remanding the complaint for its fresh disposal on merits, we have refrained from expressing any opinion on the effect of various circulars/directions and notifications issued by the Reserve Bank of India on the subject under consideration. In case the circulars/directions/notifications were not placed before the learned Ombudsman earlier, the same shall be permitted to be brought on the record by the learned Ombudsman and the parties given an opportunity to have their say in regard thereto.

The appeal is disposed of in above terms. No costs.

- C Dr. ANAND, J. Delay condoned.

The application of the petitioner to implead Reserve Bank of India as a party respondent is allowed. Mr. Salve, Senior Advocate is present on behalf of the Reserve Bank of India and waives formal notice.

- D Leave granted.

- E On identical questions of fact and law, we have disposed of an appeal arising out of special leave petition (c) No.11807 of 1997, titled *Canara Bank v. P.R.N. Upadhyaya & Ors.* Thus, for the reasons recorded therein, this appeal succeeds and is allowed. The award of the learned Ombudsman (Maharashtra & Goa) dated 10.03.1997 is hereby set aside and the matter remanded to the learned Ombudsman for its fresh disposal, on merits, in light of the observations made by us in the case of *Canara Bank* (supra). No costs.

A.K.T.

Appeal allowed.