CHAPTER V: MINISTRY OF DEVELOPMENT OF NORTH EASTERN REGION

North Eastern Development Finance Corporation Limited

5.1 Review of Non-Performing Assets

Inadequate due diligence during appraisal of projects led to NEDFI financing unviable projects. Loans were sanctioned to companies belonging to a group without considering the track record of other group companies in repaying existing loans. Fresh loans were often sanctioned and/or disbursements made even when the borrowers did not repay dues of earlier loans. The borrowers subsequently defaulted on repayments and the loan accounts eventually became Non-Performing Assets. Delay in transferring NPA accounts for initiating legal action and delays in filing legal suit was also noticed.

5.1.1 Introduction

North Eastern Development Finance Corporation Limited (NEDFI/Company) was incorporated in 1995 for providing financial assistance for accelerating industrial and infrastructure development in the North East Region. NEDFI is categorised as a Non-Banking Financial Company (NBFC) under the administrative control of Ministry of Development of North Eastern Region (DoNER). Disbursement of loans by the Company decreased from ₹348.73 crore in 2012-13 to ₹302.99 crore in 2015-16, while the Non-Performing Assets (NPAs) increased from 7.24 *per cent*[1] to 17.54 *per cent* during this period. Considering the increasing trend of NPA, the audit was carried out to analyse the causes that led the loan accounts to become NPAs.

5.1.2 Audit objectives and scope

The audit objectives were to assess whether (i) adequate due diligence was carried out prior to the sanction and disbursement of loans, and (ii) effective steps were initiated for timely recovery of dues. Audit covered scrutiny of records relating to 26 NPAs relating to Project Finance Department, having a total outstanding amount of ₹201.45 crore (more than ₹1crore in each case). Audit also scrutinised 22 out of 93 legal cases pending/settled. This audit covers the period from 2012-13 to 2015-16.

5.1.3 Audit findings

5.1.3.1 Loan Sanctioned to Individual Firms

(I) MAXIM Infrastructure and Real Estate

The Company sanctioned (September 2010) a loan of ₹22.24 crore to M/s Maxim Infrastructure & Real Estate Private Limited (MAXIM) for construction of two five-star hotels, one each in Guwahati and Shillong, at ₹238.86 crore. The Company disbursed the

[1] *as a percentage of total loan outstanding*

loan between January 2012 and September 2015. The basis of the sanction was an Memorandum of Understanding (MoU) between MAXIM and M/s Marriot Hotels India Private Limited (Marriot) signed in July 2010 which, *inter alia,* provided for five separate agreements including one for ascertaining the requirements for operation of the hotels. The Company sanctioned the loan before these agreements were finalised without clarity regarding the actual project configuration, cost, viability, means of finance, etc. despite knowing that the promoters had no experience in hospitality sector. The agreements finalised in February 2011 provided for additional rooms in the hotels (34 additional rooms in Guwahati hotel and 44 additional rooms in Shillong hotel) for achieving project viability. This increased the project cost to ₹396.17 crore and MAXIM had to arrange for additional funds of ₹157.31 crore (equity ₹61.87 crore and debt ₹95.44 crore). Since MAXIM failed to bring in additional equity, it could not arrange for additional debt funds. Audit further observed that though MAXIM informed the Company regarding this change in April 2013, the Company continued disbursing further instalments of ₹8.48 crore between April 2013 and September 2015. Due to continuous default, the loan account became NPA in March 2016 and the outstanding stood at ₹25.30 crore (August 2016).The construction of the hotels was not completed (November 2016).

NEDFI stated (November 2016) that lack of experience of the promoters in hospitality business would not have affected the success of the project since the project was conceived engaging experienced consultants. Though the project underwent important changes, lenders in the consortium decided to continue the disbursement to help project implementation.

The reply is not acceptable. The loan was sanctioned (September 2010) before conclusion of agreements between MAXIM and M/s Marriot, hence uncertainty regarding actual project configuration, cost, viability, means of finance, etc. prevailed at the time of sanction of the loan. The agreements were finalised in February 2011 before disbursement of loan commenced in January 2012. The Company, however did not follow-up the changes in the project and continued disbursement of the loan even with the knowledge that the financial closure for the enhanced project cost had not been achieved.

(II) Meghmallar Estate and Services Private Limited

The Company sanctioned (November 2008) a loan of ₹18.20 crore to M/s Meghmallar Estates & Services Private Limited (MESPL) for construction of three [1] residential complexes at Guwahati (one each at Lokhara, Tarun Nagar and Satgaon). The loan was disbursed between February 2009 and June 2012.

As per the loan policy of NEDFI, the previous experience with the promoter(s) and/ or their group ought to be considered while arriving at credit worthiness of a proposal. Audit observed that one of the promoters of MESPL was a Director of an entity[2] whose loan account with the Company had turned NPA at the time of sanction of this loan. This vital information, though available with the Company was not considered during due diligence for sanction of the loan. Though MESPL did not pay the dues towards principal, the loan account was not included under NPA.

[1] ***Lokhra -₹4.20 crore, Tarun Nagar - ₹10 crore and Satgaon - ₹4 crore***
[2] ***M/s Luit Valley Food Processing Private Limited***

Audit noticed that the Company sanctioned and disbursed (March 2014 to December 2014) an additional loan of ₹3 crore for funding cost escalation of Tarun Nagar project. MESPL used the additional loan amount to adjust the interest dues upto December 2014. It was also seen that ₹2.40 crore meant for Satgaon project was diverted by MESPL to Tarun Nagar project. In fact, after an initial expenditure of ₹1.6 crore, no further work was carried out for Satgaon project. Thus, the entire loan (₹21.20 crore) was utilised for construction of two projects instead of three.

Immediately after the account was classified NPA (June 2015), the Company granted extension of Tarun Nagar project implementation till April 2019. The Company also agreed for one-time repayment of principal in April 2019 and monthly payment of interest. The interest, however, was not repaid as per schedule and the account remained NPA. The total outstanding stood at ₹26.43 crore (August 2016).

NEDFI stated (November 2016) that

(i) The promoter of MESPL stepped into the management of the related entity in February 2008 after the death of the main promoter and liquidated the loan account of that related entity with the Company.

(ii) Diversion of loan meant for Satgaon project, utilisation of sales proceeds from Lakhora project without any repayment and sanction of additional loan were made to tide over the liquidity crunch and to facilitate the completion of Tarun Nagar project.

(iii) The loan was rescheduled since the project could not continue due to reasons not attributable to the borrower.

The reply is not acceptable. The promoter of MESPL was part of the management of the related entity as Director since September 2004. Therefore, this fact should have been considered in the due diligence. Rescheduling effectively extended recovery of interest on the loan till April 2019 and principal beyond that. In order to facilitate completion of the project, the Company extended undue concessions which were detrimental to its interests.

(III) Kakoti Engineering Works

The Company sanctioned (November 2010/October 2012) two loans of ₹11 crore and ₹12 crore to M/s Kakoti Engineering Works (KEW) for procuring gas gensets for supply of power to Oil and Natural Gas Corporation Limited (ONGC). The loans were sanctioned on the basis of the contract between KEW and ONGC. Later (March 2014), the Company sanctioned another loan of ₹3 crore to adjust the dues of previous loans.

Audit observed that the contract between KEW and ONGC did not have any condition binding ONGC to a for committed off-take of power. The loan, however, was sanctioned on the premise that ONGC would draw designed capacity of the gensets throughout the tenure of contract. In actual operation, off-take of power by ONGC was low resulting in lower capacity utilisation of gensets (below 40 *per cent*) and lower revenue, which affected repayment of loan dues. The Company also sanctioned a second loan to KEW which was used to adjust overdue interest of previous loan. The loan account became NPA (September 2014) and the outstanding stood at ₹28.68 crore (August 2016).

NEDFI stated (November 2016) that initially the project was running well with ONGC drawing the designed power. Lower utilisation of gensets affected the revenue of KEW and that legal action had been initiated for recovery of dues.

The reply is silent on why the Company did not consider that ONGC had not committed to a specific offtake in their agreement with the borrower at the time of loan sanction. Further, sanctioning additional loan to clear overdue amounts of earlier loan was imprudent.

(IV) Ghosh Brother Auto Sales Private Limited

The Company sanctioned (June 2011) a loan of ₹5.50 crore to M/s Ghosh Brothers Auto Sales Private Limited (GBAS) for setting up Honda cars dealership and workshop at Dibrugarh, Assam. The loan was disbursed between August 2011 and March 2012, and the dealership started functioning in 2012. The loan was sanctioned based on an annual capacity of 1200 cars with 30 *per cent* capacity utilisation in the first year, progressively increasing to 60 *per cent* in the fourth year. GBAS could not achieve the projected sales and no payment was made against the principal due since October 2013.

Audit observed that the loan appraisal note indicated that an average annual sale of Honda cars in Guwahati, the main business centre of North Eastern Region (NER) was 1272 cars (*i.e.*, 106 cars per month). Considering an annual sale of 1200 Honda cars in Dibrugarh was unrealistic in this context. Audit also observed that the Company, instead of declaring the account NPA, rescheduled (March 2014) the loan with repayment from April 2015. This was not as per norms for re-scheduling loans laid down by RBI[1]. GBAS failed to adhere to the conditions of reschedule, yet the Company did not exercise the right to reverse it and take action for recovery. The account was classified (June 2015) NPA and the total outstanding stood at ₹6.36 crore (August 2016).

NEDFI stated (November 2016) that installed capacity was finalised based on discussion with the borrower taking into account the sales in other showrooms of the borrower, expected demand on account of increased industrial/commercial activity in Dibrugarh and sales from upper Assam and from parts of Arunachal Pradesh and Nagaland. Slowdown in automobile industry, however, resulted in lower capacity utilisation and the loan was rescheduled as per RBI norms. Since the unit could not revive itself, legal action was taken in May 2016.

The reply is not acceptable. Fixing installed capacity based on information of other locations was not a judicious approach and in this case as an un-realistic one. No market study was carried out to ascertain the expected sales from the target geographical areas realistically. Further, no rescheduling of loan should be done for un-viable projects as per RBI guidelines. As un-viability of the project was established, the project should not have been re-scheduled.

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[1] ***The RBI guidelines (para 4.1.4 of Master Circular – Systemically important NBFC Prudential Norms), laid down that 'no account will be taken up for restructuring by the NBFCs unless the financial viability is established and there is a reasonable certainty of repayment from the borrower as per the terms of restructuring package'.***

(V) P Das and Company

The Company sanctioned (February 2010) a loan of ₹4.50 crore to M/s P Das and Company (PDC) for execution of civil works of a power project of Assam Power Generation Company Limited (APGCL) at a contract price of ₹27.20 crore. As per the terms and conditions of the loan, PDC opened an escrow account with IDBI Bank. All proceeds of the contract were to be deposited in this account.

Audit observed that the above contract price was based on 2007 price level. As against an estimated cost of ₹44 crore, PDC bid the contract for ₹39 crore, while the second lowest quote was ₹70 crore. The borrower won the contract in July 2007, but it could not carry out the works due to withdrawal (2008) of JV partner responsible for the electrical and mechanical components. Another party was brought in (August 2008) for these works at ₹19.88 crore against ₹11.80 crore estimated by the first party. The civil cost at 2007 rates were also not revised by the borrower. The Company did not consider the viability of the borrower's quote in the context of cost escalation before sanctioning the loan in 2010 when these events were known. The Company made the first disbursement of ₹2.50 crore in December 2010. The second disbursement of ₹2 crore was made in October 2011, despite being informed (May 2011) that the technical information in bid documents was erroneous and there had been a resultant increased volume of work. Since PDC could not execute the works, APGCL terminated (August 2012) the contract. It was also observed that PDC had received ₹3.42 crore directly from APGCL without routing the same through escrow account, while no repayment of principal was made. The account became NPA in March 2014, but legal action was initiated only in April 2016. The total outstanding stood at ₹6.76 crore (August 2016).

NEDFI stated (November 2016) that the loan was sanctioned on the merit of the proposal and past credentials of the borrower. Out of the amount directly received, the borrower paid ₹1.46 crore and balance amount used for project expenses. The project execution failed due to technical as well as inherent local problems causing cost escalation, which APGCL did not agree to. Legal action was initiated since time given to the borrower to arrive at a settlement with APGCL and Government of Assam did not fructify.

The reply is not acceptable. The loan was processed in 2010 when the un-viability of the project on account of low quoted price (at 2007 price level) should have been considered. The local law and order issues were known even before sanction of the loan. By obtaining contract payments directly, without paying Company dues, the borrower defeated the purpose of escrow account which ought to have been objected to by the Company.

(VI) Assam Paper Mill

The Company sanctioned (February 2005, a loan of ₹2.40 crore to M/s Assam Paper Mills Private Limited (APM) for setting up a kraft paper manufacturing unit. Subsequently, the Company sanctioned (March 2007) another loan of ₹2.34 crore for enhancing the capacity of the plant from 15 tonne to 50 tonne per day.

Audit observed that since there was lack of continuous power supply, APM installed two diesel generators and the same could not be operated on a sustainable basis due to higher fuel cost which affected the viability of the project. Despite being aware of this, the

Company sanctioned the second loan. The capacity enhancement proved detrimental to the overall project and APL registered huge losses from operation, leading to closure of the factory since October 2012. The loan account became NPA in September 2013 and the total outstanding stood at ₹4.85 crore (August 2016).

NEDFI stated (November 2016) that the project was implemented well and production of kraft paper was started. Non-availability of continuous power supply led to huge losses and affected the viability of the unit. The Company initiated legal action and the Debt Recovery Tribunal gave (September 2016) judgment in its favour. The dues are yet to be recovered.

However, the fact remains that the second loan was sanctioned knowing that continuous power supply to operate the plant even with original capacity was not available.

(VII) Wokha Coal Mines

The Company sanctioned (March 2010) a term loan of ₹1.45 crore and working capital loan of ₹0.40 crore to M/s Wokha Coal Mines (WCM) for the development of a coal mine.

Audit observed that the Detailed Project Report (DPR) estimated availability of coal without full information on the sub-surface[1]. Therefore, the availability of coal seam[2] and coal as envisaged in the DPR was subject to change. The project was considered viable on the basis of limited drilling and field study. The DPR itself indicated that in order to get more accurate and reliable data about availability of coal, more drilling and field study was required. These doubts regarding the viability of the project was not considered by the Company while sanctioning the loan. WCM could not mine good quality and adequate quantity of coal which affected the revenue generation of the project. Due to continuous default, the loan account became (March 2014) NPA and the total outstanding stood at ₹2.23 crore (August 2016).

NEDFI stated (November 2016) that the loan was sanctioned based on the DPR prepared by experts and the promoters had, on various occasions, informed that they found rich coal seam. The borrower was paying instalments even after the account became NPA, but could not regularise the account. Therefore, it took necessary legal action for recovery of dues.

The reply is not acceptable. The DPR did not conclusively indicate that sufficient quantity and good quality of coal was available for viable operation of the mine. Instead, it suggested more drilling and field study in order to arrive at a more accurate data while stating that the quality and quantity of coal envisaged in the report was subject to change depending upon surface conditions. The sanction of loan under these conditions was thus, imprudent.

[1] ***Earth material (as rock) near but not exposed at the surface of the ground.***
[2] ***A stratum of ore or coal thick enough to be mined with profit.***

5.1.3.2 Loans Sanctioned to Group of Companies

As per the credit appraisal standards laid down in the Loan Policy of NEDFI, 'previous experience with promoter (s) and/ or their group' should be considered while deciding credit worthiness of a proposal. Audit noticed that this standard was not adhered to in case of loans to group companies as discussed below:

(I) UD Group of Companies

The Company sanctioned and disbursed working capital loans to M/s Abhi Coke Limited (ACL), M/s Victor & Company (VC) and M/s Satyam Contractors Limited (SCL) and a term loan to M/s JSB Cement (JSB) belonging to UD Group of Companies.

Audit observed that working capital loan of ₹5 crore to ACL was sanctioned in August 2010 and disbursed by September 2010. Although, ACL was irregular in payment of interest dues, the Company disbursed working capital loans of ₹1.90 crore to VC (December 2010) and ₹3.80 crore to SCL (August 2011). Despite default by VC and SCL, the Company again sanctioned (March 2011) a term loan of ₹15 crore to JSB and disbursed the same between August 2011 and January 2012. JSB also defaulted in repayment of dues.

The sanction and disbursement of loan to a member company of the group, when another member company in the same group had defaulted, was not prudent. During 2013-14, ACL transferred ₹4.40 crore to JUD Cement (another group company of UD Group), and during 2012-13 and 2013-14, VC transferred ₹2.18 crore to JUD Cement and ₹0.48 crore to ACL. The transfer of funds among group companies, without liquidating their dues tantamounts to wilful default on the part of the borrower, as per RBI guidelines applicable to NBFCs. The loan accounts of all the borrowers became NPA between March 2013 and September 2014.VC liquidated its dues by August 2015. The dues from ACL, JSB and SCL amounting to ₹33.43[1] crore remained outstanding (August 2016).

NEDFI stated (November 2016) that at the time of sanction of the loan to JSB, loan accounts of ACL, SCL and VC were standard. At the time of transfer of funds, the Company did not have any control over the operations of bank accounts of group companies. When the matter came to notice, it directed the borrower to revert the funds thus transferred.

The reply is not acceptable. The loan accounts of both VC and SCL were in default for eight months between January and August 2011, but these were not classified as NPA. Similarly, in the case of ACL, the payments were irregular and no payment was made between January 2011 and January 2012 (except one payment in June 2011 to facilitate the disbursal of the loan to JSB in August 2011). Repeated intra group transfer of funds while not servicing the outstanding loans, points to inaction of the Company.

[1] *ACL ₹5.58 crore, JSB ₹24.05 crore and SCL ₹3.80 crore*

(II) Sandeep Bhagat Group of Companies

The Company sanctioned (September 2011) a loan of ₹7 crore to M/s Shree Sai Prakash Alloys Private Limited (SSPL), a group company of Sandeep Bhagat Group of Companies, for its TMT Bar and Billet manufacturing unit. The loan was disbursed in January 2012. SSPL had defaulted on repayments. Till March 2013, only one payment had been made (in May 2012) after which the repayment was irregular. In March 2013, the Company approved deferment of principal repayment from April 2014 onwards due to adverse market conditions. The Company sanctioned (March 2014), a loan of ₹5 crore to another company in the group, *viz*., M/s Shree Sai Rolling Mills (SRM), for its TMT Bar manufacturing unit. The sanction of loan to SRM was not prudent since SSPL engaged in similar business had been in default and the Company had already approved deferment of repayment of SSPL loan in view of adverse market conditions. SRM also did not repay any amount towards its due. Due to continuous default, the loan accounts of both SSPL and SRM became NPA (June 2015) and the total outstanding stood at ₹9.62 crore (August 2016).

NEDFI stated (November 2016) that at the time of sanction of the loan to SRM, loan account of SSPL was standard. The group suffered mainly due to downturn in steel industry and defaulted in repayment.

The reply is not acceptable. The loan account of SSPL remained standard due to postponement of the repayment of principal allowed by the Company. The sanction of the loan to SRM while postponing loan repayment of SSPL was imprudent.

(III) Sanyeeji Group of Companies

The Company sanctioned (February 2011) a loan of ₹17.50 crore to M/s Shree Sanyeeji Ispat Limited (SSIL), a member of Sanyeeji Group of Companies, for liquidation of an existing cash credit account with IDBI ₹13.50 crore) and for meeting working capital requirement (₹4 crore) of its TMT Bar unit. The loan was disbursed by March 2011.

Audit observed that despite the fact that SSIL was irregular in repayment of dues, the Company sanctioned (September 2011) another loan of ₹15 crore to M/s Shree Sanyeeji Rolling Mills (SSRM), another member company in the Group, for its TMT Bar unit. SSRM was also irregular in payment of its dues; yet the Company sanctioned and disbursed (March 2014) another loan of ₹6 crore to SSIL, ignoring that the irregular repayment pattern of the group companies and the fact that the total outstanding of the Group with different financial institutions was ₹150.82 crore at that time. It was also observed that SSIL sold (January 2013) a piece of land for ₹19 crore. This land was given as collateral security against the first loan of ₹17.50 crore. But, instead of adjusting the entire amount towards dues, the company accepted (January 2013) ₹10 crore only. The loan accounts of both SSIL and SSRM became NPA (June/September 2015) due to continuous non-payment of dues and the outstanding stood at ₹26.20 crore (August 2016).

NEDFI stated (November 2016) that considering the good business relation with the Group, it found an opportunity to enhance its business and sanctioned the first loan. Subsequent loans were sanctioned to meet operational requirements of respective units, considering their good repayment record. The entire proceeds from sale of land was not adjusted against repayment to maintain business relations with the borrowers. The borrowers defaulted due to slowdown in steel industry and initiated legal action for recovery of dues.

The reply is not acceptable. Downturn in the steel industry was a known fact since 2009. The Company continued to sanction loans to SSIL and SSRM, though they were not regular in repaying loan instalments. The Management reply that the Group enjoyed good repayment record was, therefore, factually incorrect. The second and third loan was sanctioned without taking into account the overall credit exposure of the Group with other financial institutions. Further, non-adjustment of entire sale proceeds against outstanding dues was not a prudent practice for safeguarding the Company's financial interest.

(IV) Santosh Jaiswal Group of Companies

Brahmaputra TMT Bars Private Limited (BTMT), Brahmaputra Tubular Private Limited (BTPL) and Brahmaputra Iron and Steel Company Private Limited (BISCON) under Santosh Jaiswal Group availed five loans amounting to ₹54.70 crore between March 2010 and October 2013.

Audit observed that since these borrowers were not regular in repayment of their dues, the loan accounts became NPA in December 2013. The Company sanctioned (March 2014) another loan of ₹5 crore to BTPL for financing a project. On request of the borrower, the Company disbursed ₹4.56 crore on this loan and adjusted the same towards the overdue principal (₹2.04 crore) and interest (₹2.52 crore) of earlier loans given to BTPL, BTMT and BISCON. No further disbursement was made against this loan. Thus the new loan was sanctioned to avoid NPA status of the other loan accounts of the group. The borrowers did not repay any further amount towards the overdue principal. Subsequently, all the six loan accounts became NPA in September 2014 and total outstanding stood at ₹58.91 crore (August 2016).

NEDFI stated (November 2016) that at the time of sanction of ₹4.56 crore to BTPL, the loan accounts of BTPL and BTMT were standard. This loan was sanctioned against subsidy receivable, which was expected in 2015-16. The slowdown in iron and steel industry affected the borrowers also, which led to default in servicing the loans.

The reply is not acceptable as all the five loans had become NPA in December 2013 since repayments against these loans were pending for more than 90 days at that time. Slowdown of iron and steel industry was a known fact at the time of sanction of the sixth loan, and in effect the last loan was used to adjust overdue payments from earlier loans.

5.1.3.3 Legal actions for recovery of dues

The loan policy of the Company provided for taking legal action for recovery of dues in respect of NPA accounts where regularisation through usual follow up was not possible. It also provided 30 days from the date of receipt of cases from Departments concerned for filing legal suits.

Audit observed that NPA cases were referred to Legal Department after 14 months to 81 months (as noticed in 22 out of 93 NPA cases pending on 31 March 2016). There was a delay ranging from 3 months to 52 months in filing legal suits by the Legal Department (over and above the prescribed 30 days). These delays were crucial since in a number of cases, the outstanding amount accumulated to a considerable extent and often exceeded the value of securities held by the Company against such loans. Such delays have led to a situation where recovery of entire dues even after disposing the available securities have become doubtful.

While agreeing on the need for timely legal action, NEDFI stated (November 2016) that legal action was the last resort and the defaulters were given time for liquidation of dues before initiating such action. As a development finance institution, its efforts was to help the entrepreneur and explore all options for revival, unless there was strong reason to believe that the borrower was defaulting wilfully.

The reply is not acceptable. Audit noticed huge delays both in transfer of cases and in filing legal suits, which cannot be treated as reasonable. Though the intention of helping the entrepreneur is appreciated, such efforts should not affect the prospects of recovering the entire dues within reasonable time.

Conclusion

Deficiencies in the due diligence of loan proposals of the borrowers were noticed in a significant number of cases. Industry and company specific issues were not given due consideration at the time of appraisal of the projects, which led to financing unviable projects, continuous default by the borrowers and loan accounts eventually becoming NPA. Fresh loans were sanctioned and/or disbursements made even when the borrowers did not repay dues of earlier loans. Loans were sanctioned to companies belonging to a group without considering their overall exposure with the Company as well as with other financial institutions and the track record of member companies in repaying loan instalments in respect of existing loans. Delay in transferring NPA accounts for initiating legal action and delays in filing legal suit was also noticed. This effectively deferred recovery process to the detriment of the Company interests.

The matter was reported to the Ministry in November 2016; their reply was awaited (January 2017).