Article

The defaulter's will: leaving harsh implications to administrative discretion

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The concept of "willful default" is something which has always been considered to be an abuse to the economics of financial transactions by the Indian regulators. The regulators, have time and again come up with new ways of tackling these instances. Currently, wilful defaulters are dealt with in accordance with the guidelines[1] laid down by the RBI in this regards.

The guidelines are more inclined towards treating of a wilful default than the manner of classification of wilful defaulters.

Classification of wilful defaulters

The guidelines entrust the senior administration of the lending institutions with the power to classify a borrower as a wilful defaulter.

The guidelines define "wilful default" in the following manner –

> *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.*

[1] https://www.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9907

We can summarise the above to say that a default will be treated as wilful default where a borrower refrains from meeting its obligations despite having the ability to do so.

The power to decide whether a default is deliberate or genuine has been bestowed upon a committee of the lender headed by an Executive Director of the lender along with two other senior officers of the rank of GM/ DGM.

The decision of the said committee, if positive, is subject to the approval of a review committee has the final say on whether to treat a borrower as wilful defaulter or not. The said review committee is headed Chairman / Chairman & Managing Director or the Managing Director & Chief Executive Officer / CEOs and consisting, in addition, to two independent directors / non-executive directors.

Therefore, the ultimate authority to label a borrower as wilful defaulter lies in the hands of lender.

Defense available in the hands of the borrower

The only way a borrower can prove himself to be clear of all charges is by giving a suiting reply to the show cause notice issued by the committee meant for identification of wilful defaulters, where it is of the view the borrower has shown signs wilful default.

Besides the above, the borrower and promoter/ whole time director may be allowed an opportunity of being heard but that too where the identification committee deems it fit. Therefore, here again, the right to give an opportunity of being heard to the borrower rests in the hands of the lender itself.

Who can be termed as a wilful defaulter?

If a company is termed considered as a wilful defaulters, the following directors of the company shall be named as wilful defaulters –

(i) whole-time director;

(ii) where there is no KMP, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;

(iii) every director, in respect of a contravention of any of the provisions of Companies Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings and who has not objected to the same, or where such contravention had taken place with his consent or connivance.

Non whole time directors will be considered as wilful defaulters only if the following are satisfied:

a. that he was aware of the fact of wilful default by the borrower by virtue of any proceedings recorded in the minutes of meeting of the Board or a Committee of the Board and has not recorded his objection to the same in the Minutes; or,

b. that the wilful default had taken place with his consent or connivance.

However, none of the above conditions are to be satisfied before naming a non-whole time director as wilful defaulter, where he is a promoter of the company as well.

Where is the concept of natural justice?

Having gone through the process of characterization of wilful defaulters, one thing that is bothering us is that the principle of natural justice is severely jeopardised in this situation. The principles of natural justice are in two-folds – a) *Audi alteram partem* i.e. a right of being heard*; and b) Nemo judex in causa sua* i.e. no one should be the judge of its own cause. The tag of wilful defaulter is almost like reading the mind of the defaulter, which is getting into *mea culpa* of the defaulter. Up till now this was reserved to criminal courts in the country, and if the RBI's guidelines have their say, ultimate powers will be bestowed upon a bunch of bankers who will now deliver in a matter in which they are party to and decide to call someone a wilful defaulters without even giving the defendant necessary opportunity of being heard.

The matter was also discussed at length in *Kotak Mahindra Bank vs. Hindustan National Glass & Ind. Ltd.*[2], where it was held that by Bombay High Court that the RBI Master Circular covered default by a party in complying with the payment obligations under derivative transactions. The HC observed that it would be open to the Grievance Redressal Committee to pass fresh orders in accordance with law after complying with the principles of natural justice.

Implications of being labelled as wilful defaulter

There are several implications a person who is named as wilful defaulter in the list of willful defaulters published by the RBI or CIC. These implications were originally laid down by the RBI but recently, the board of SEBI has also come with a recommendation to deny the wilful defaulters access to capital markets.

Penal measures prescribed by the RBI

On being characterised as a wilful defaulter attracts several implications for the accused namely –

[2] http://judis.nic.in/supremecourt/imgs1.aspx?filename=39808

a. Accused to be named as wilful defaulter in the list published by the RBI and Credit Information Companies, which of course is meant to be put up on the public domain.

b. *Debarring from institutional finance* - The accused shall not be eligible to avail any further funding by any bank/ financial institution. Where instances like siphoning / diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions have been identified within the accused companies, a ban of another 5 years from the date of the removal of name from the list of wilful defaulters shall be imposed on such companies with respect to raising of funds from institutions like scheduled commercial banks, financial institutions, NBFCs for setting up of new ventures.

c. The lenders shall have the right to *initiate criminal proceedings* against the accused wilful defaulters.

d. *Debarring directorship in the companies having institutional finance* – The banks/ financial institutions have right to insert clauses in the agreements with the companies on which they have fund based/ non fund based exposures to the effect that such borrowing entity does not induct on its board anyone named in the list of wilful defaulters or where the person already on the board, necessary steps to be taken to expedite the process of removal of such directors from the board.

Penal measures prescribed by the SEBI

As if the measures prescribed by the RBI were not sufficient enough to make the lives of the wilful defaulters, that the SEBI also had to come up with something. The recommendations from the board meeting of the SEBI in this regard –

a. A company shall not be allowed to make public issue of equity securities / debt securities / non-convertible redeemable preference shares, if the issuer company or its promoter or its director is in the list of the wilful defaulters.

b. Any company or its promoter or its director categorized as wilful defaulter may not be allowed to take control over other listed entity. However, if a listed company or its promoter or its director is categorized as wilful defaulter, and there is a take-over offer in respect of the listed company, they may be allowed to make competing offer for the said listed company in accordance with SEBI (SAST) Regulations, 2011.

c. The criteria for determining a *'fit and proper person'* in SEBI Regulations will be amended to include that no fresh registration shall be granted to any entity if the

entity or its promoters or its directors or key managerial personnel, as defined under SEBI (ICDR) Regulations, 2009, are included in the list of wilful defaulters.

Are we heading towards an era of reactive law making?

There have been several instances in the past indicating that the country is slowly moving towards reactive law making from a proactive law making. Killing of optionally convertible debentures under the Companies Act, 2013 is a classic example of reactive law making, as the experts consider it to be nothing but an aftermath of the Sahara issue. Similarly, this decision of SEBI is clearly a reaction to the recent spate of news on big time wilful defaulters.

Law making cannot be based on contemporaneous waves of public sentiment. If judges start acting on "conscience of the nation", and lawmakers start playing the gallery, society will be at a severe threat, as such behaviour will be no different from a mob reaction which reacts with an outburst of temporal emotion.

But sadly, the recent activities of the regulators give a clear indication of where are we headed to.

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