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## Hon'ble Mr. Justice Manmohan

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# Demystifying the Identity of Real Wilful Defaulters

“If you owe your bank manager a thousand pounds, you are at his mercy. If you owe him a million pounds, he is at your mercy”  
- J.M. Keynes

## ■ Sachin Gupta & Karan Batura

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any companies and individuals have defaulted in paying their loans due to the economic slowdown, technology change,

technology upgrades, and other factors. These are known as defaulters. However, the Banks and financial institutions declare these defaulting entities as ‘wilful defaulters’.

The scheme of wilful defaulters was introduced by the Reserve Bank of India pursuant to the instructions of Central Vigilance Commission during the year 1999 and subsequently modified. As per the Master Circular for Wilful Defaulters, a wilful default would be deemed to have occurred if any of the following events are noted:

(a) The unit has defaulted in meeting its payment/repayment obligations to the Lender even when it can honour the said obligations.

(b) The unit has defaulted in meeting its payment/repayment obligations to the Lender and has not utilized 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, 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 to secure a term loan without the knowledge of the bank/lender”.

However, the essential part of the Circular states that “The identification of the wilful default should be made



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keeping in view the track record of the borrowers and should not be decided based on isolated transactions/incidents. The default to be categorized as wilful must be intentional, deliberate and calculated”.

The Banks and Financial Institutions on a default committed by the Borrower and the account turning a ‘Non-Performing Asset’ (NPA) initiate the proceedings of wilful default against the Borrower. The Banks are not considering the important part of the Circular as stated above before initiating such proceedings. The Banks are using the circular as an easy way to surmount the various directions of Reserve Bank of India.

It is often found that a borrower with many years of standing is branded

as a wilful defaulter all of a sudden when his account is classified as NPA. The Wilful defaulter allegations are on the basis of transactions done by the Borrower in prior years and have been in the knowledge of the banks. The Bank not only conducts an audit of the account of the Borrower but is itself subjected to various internal and statutory audits. Why does the issue of Wilful defaulter arise after the Borrower’s account turns NPA. Do the bankers do it to avoid being subject to any scrutiny and hide their lapses. If the Banks do a proper periodical review of the accounts, then the defaults can be avoided. However, there are a certain number of genuine cases wherein companies and individuals that fail to pay back do so due to financial distress and the economic downturn. These kinds of cases have rampantly come

up during this pandemic, wherein the worst-hit industries such as hospitality, entertainment, manufacturing, etc., have been unable to pay their liability.

Lenders prefer to choose this course of action as a declaration of a company/business/individual as a wilful defaulter attracts a lot more drastic consequences. Lenders get the right to report the names of the companies as wilful defaulters and the right to report the names and publish the photographs of the directors of the company as wilful defaulters. Further, the lenders also have been provided with the right to change the management of the wilful defaulting company. The worst thing that can happen if one is labeled as a wilful defaulter is it pretty much chokes off most credit channels since no additional lending facility is available from any

bank or institution. In addition, it also shuts the door on any new ventures — a wilful defaulter is not permitted to float any new business for five years from the date of being declared a wilful defaulter. The fundamental right to carry on the business of one's own choice is affected after the declaration of a wilful defaulter.

However, the absence of any provision in the RBI Master Circular regarding legal assistance in case of wilful defaults, the Apex Court has in its judgment in the case of "State Bank of India vs. Jah Developers Pvt. Ltd. and Ors." prescribed steps to be followed by the Lenders and the remedy available to the Borrower.

## KNOW YOUR RIGHTS AS A LOAN DEFAULTER

Therefore, there is a dire need to differentiate between the real wilful defaulters and the normal loan defaulters, as such malafide cases have been on the rise since the start of the global pandemic. Borrowers who are dubiously declared as wilful defaulters should be made aware of their rights, and therefore this article aims to point out the borrowers' rights to put forth their case. Per the RBI master Circular dated 01.07.2015 on 'wilful defaulters' and various judicial pronouncements in this regard, the following defenses can be availed by a borrower and its directors (in case of a company):

1. The Lender has to prove that the default on the Borrower's account is willful. The main circumstance that has to be proved is the ability of the Borrower to pay back the debt. If the Borrower has no means and capability to pay back a loan, it cannot be declared as a wilful default. The Hon'ble High Court of Bombay, in this regard, has held that

a mere default is not enough to declare a borrower as a wilful defaulter. An intentional, deliberate act is required to be proved to fall within the definition of wilful default. The borrower company, its promoter/whole-time director, can only be subjected to such a declaration if there is evidence.

Therefore, the Borrower can take up this defense if the default is unintentional and inadvertent.

2. A Director of the borrower Organization/ Company cannot be held responsible for the wilful default of such organization without any proof. It is the primary responsibility of the Lender to make specific averments so as to make the accused vicariously liable. There is no presumption that every Director knows about the wilful default transaction. Only those people who were in charge of and responsible for the conduct of the business of the borrower Company at the time of the commission of an offence will be liable for criminal action.

Therefore, the Directors of the borrower Organization/Company can take up this defense in case no specific allegations/averments have been made against them and where they do not know whatsoever of the default.

3. The borrower / alleged wilful defaulter should be provided with all the relevant documents that the authority has relied upon in arriving at a decision. Therefore, the delinquent must have the entirety of the materials placed before the Identification Committee for the delinquent to give a meaningful submission. As personal hearing is not compulsory under the RBI Master Circular on wilful defaulters, the committees must apply its mind in the whole process and

provide the documents that have been relied upon to the Borrower. Further, in a circumstance where the documents relied upon by the Lender are already in the possession of the Borrower, the Lender must identify the transactions upon which the Bank seeks to rely.

Therefore, the Borrower can take up this defense in case he/she/it has not been provided with the relevant documents being relied upon by the authority.

4. The accused Borrower has the right to make a representation based both on facts and law (if any) to the Lender Bank. A two-tier mechanism (consisting of the identification committee and the review committee) is provided as a safeguard; because the declaration of a person as a wilful defaulter invites both civil and criminal consequences. As a matter of right, the accused Borrower has an opportunity to represent its case before both of these committees post receiving the necessary documents relied upon by the Lender. Further, the alleged wilful defaulter may also be granted the opportunity of personal hearing in cases where the Lender deems it fit.

Therefore, the Borrower can take up this defense in case no opportunity of representation/personal hearing is provided, that the declaration as wilful defaulter is arbitrary and without following of the procedure as provided by the Apex Court and RBI Master Circular on wilful defaulters.

5. Recently, the Government of India notified the Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019 on 15.11.2019,


thereby making Part III of the Insolvency and Bankruptcy Code, 2016 (“IBC”) separately applicable to personal guarantors, as a result of which, a creditor has been empowered to initiate separate insolvency proceedings against personal guarantors to corporate debtors. Though the constitutional validity of such provisions was challenged, the Hon’ble Supreme Court of India upheld the same. In section 95 of IBC under Part III, as soon as an application is filed for initiation of a personal insolvency of a personal guarantor, an interim moratorium is automatically deemed to commence in favour of such personal guarantor provided for in section 96 of IBC.

Wilful defaulter proceedings ought to be squarely covered under such interim moratorium provided for under section 96 of IBC, the said section being akin to Section 14 of IBC. As a continuance of wilful defaulter proceedings in respect of a borrowing company is construed to fall within the purview of the moratorium stipulated in Section 14 of the IBC, the same are accordingly also construed to fall within the scope of section 96 of IBC, both the sections being *pari materia*. Hence, in a circumstance where a Lender Bank has initiated wilful defaulter proceedings against an Accused, in favour of whom an interim moratorium has kicked in under section 96 of IBC, such wilful defaulter proceedings are liable to be stayed, and the Lender Bank is restrained from taking any further action.

Therefore, an Accused can take up this defense in a case where an application for initiation of insolvency proceedings of a personal guarantor has been filed against him and an interim-moratorium under section 96 of IBC has commenced in his/ her favour.

6. Lastly, in a circumstance where the Borrower Company is under a Corporate Insolvency Resolution Process and its Resolution Plan has been approved, i.e. the money is either paid to the Lender or is deemed to be paid. The Borrower Company is absolved of its liability, all of the Directors of the Borrower Company, other than those who have provided a personal guarantee, also stand exonerated/exculpated of their liability if the wilful default proceedings initiated against them were initiated in respect of such default.

Therefore, the directors of the borrower company can take up this defense if the borrower company is absolved of the liability vis-à-vis the Lender by way of resolution plan and if the directors have not further any personal guarantee. Further, it is also imperative that the wilful defaulter proceedings initiated against the directors of the borrower company should be in respect of the said default of which the company has been absolved of.

Wilful defaulters were one of the main reasons for India’s economic slowdown before the Covid-19 outbreak. Wilful defaulters deserve stringent and harsh punishment for their acts. That being said, defaulters who cannot pay due to situations beyond their control should not be subjected to the same kind of punishment as wilful defaulters. The criminal law of India is based upon two pillars – “mens rea” and “actus reus”. Mens rea is an essential element in criminal cases and all of the cases. A person’s intention to knowingly and willingly commit a crime always deserves higher and more severe punishment than a crime committed without intent. 



**Sachin Gupta** heads the Litigation Practice of the Firm as a Senior Partner, with prime focus on complex civil & commercial litigation and arbitration matters. He handles matters in the Supreme Court of India, High Courts and various Tribunals, other quasijudicial and alternate dispute resolution forums.



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