INDIA'S NO.1 MAGAZINE ON BUSINESS & LEGAL WORLD

ARA LEGAL MEDIA GROUP

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LEGAL ERA

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www.legalera.in | April 2016 Vol. VII Issue I

₹ 70 | US $7 | £5

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Wilful Defaulter Legal Ambiguity

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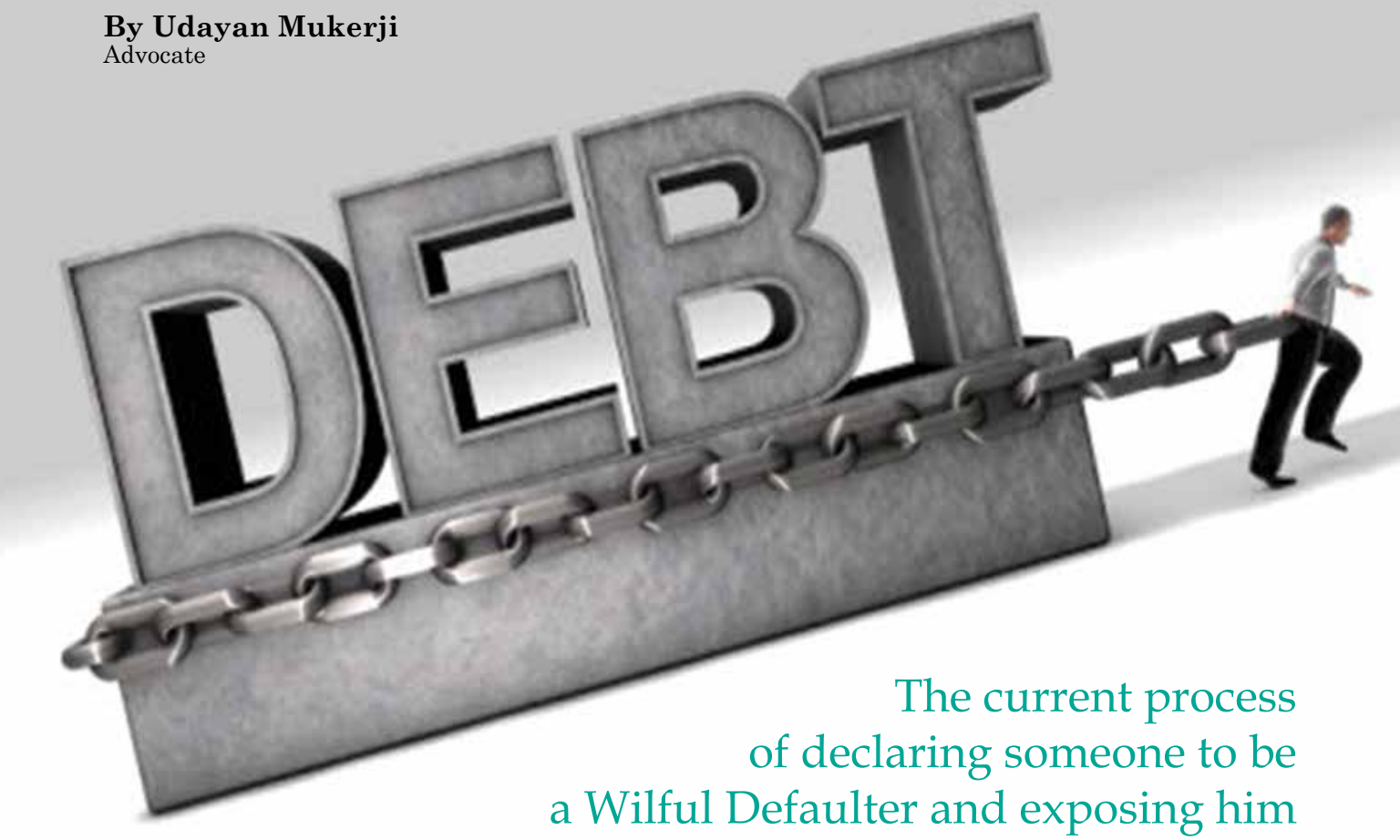


The current process of declaring someone to be a Wilful Defaulter and exposing him to direct and indirect penalties needs thorough recasting to conform rigorously to the requirements of equity, natural justice and procedure established by law

1. The expression "Wilful Defaulter" has shot into a great deal of prominence lately, thanks to the publicity attracted by the alleged financial shenanigans of Vijay Mallya as well the phenomenon of successive banks declaring him to be one. In the midst of all this brouhaha, something that has hitherto escaped serious examination is whether the entire process of labelling someone as a Wilful Defaulter and the attendant consequences of such a categorisation can stand up to legal scrutiny.

2. Scheduled commercial banks decide upon and classify purportedly financially delinquent borrowers as Wilful Defaulters under the authority of and in line with RBI Circular No. RBI/2014-15/73 - DBR.No.CID. BC.57/20.16.003/2014-15 as updated on 7 January 2015 (issued under the authority of the Banking Regulation Act, 1949). A perusal of the operative portions of this Circular discloses that the RBI has de facto invested banks with quasi judicial functions and authority to frame charges of financial delinquency against a borrower, hold hearings, take evidence and pass orders including, to wit, classifying the alleged delinquent as a Wilful Defaulter.

3. That banks have been equipped, by the RBI, with the trappings of a Tribunal can be deduced from the language of the Circular. (a) the "**evidence**" of wilful default is examined by a "Committee headed by an Executive Director and consisting of two other senior officers of the rank of GM/DGM"; (b) the Committee issues a Show Cause Notice to the concerned borrower and calls for submissions and after considering their submissions, issues an **order** recording the fact of wilful default and the reasons for the same. An opportunity may be given to the borrower for a personal hearing if the Committee feels such an opportunity is necessary; (c) this is followed by "**Penal Measures**" which include the bank conveying the list of such wilful defaulters to the RBI and the RBI, in turn, conveys this information to SEBI and the Credit Information Bureau (India) Ltd. (CIBIL); (d) thereby, no Financial Institution (FI) or bank may lend any monies to such a Wilful Defaulter and other borrowers must covenant with the bank that they shall either not have a Wilful Defaulter on their Board or shall drop him forthwith if already on their Board and (e) SEBI shall debar such a Wilful Defaulter from accessing markets.

4. The entire procedure is reminiscent of a comical exchange in Alice in Wonderland between the Fury and the Mouse; "I'll be judge, I'll be jury, said cunning old Fury: I'll try the whole case and condemn you to death". The RBI Circular completely misses the fact that a bank (the lender in a borrowing agreement) is one of the parties to the contract with the borrower and may be equally, if not more, to blame for lapses, laxity and maybe even complicity in regard to deficiencies in record, the misdirection/misapplication of funds, gaps (deliberate or negligent) in oversight, dilution of securities and misrepresentation (fraudulent or otherwise). The RBI drapes banks with the accoutrements of a tribunal overlooking the basic fact that the plaintiff (the bank) cannot be the judge in its own case let alone "**impose penal action**".

5. The RBI Circular goes on to say "It is advised that in terms of Section 128 of the Indian Contract Act, 1872, the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. Therefore, when a default is made in making repayment by the principal debtor, the banker will be able to proceed against the guarantor/surety even without exhausting the remedies against the principal debtor. As such, where a banker has made a claim on the guarantor on account of the default made by the principal debtor, the liability of the guarantor is immediate. In case the said guarantor refuses to comply with the demand made by the creditor/banker, despite having sufficient means to make payment of the dues, such guarantor would also be treated as a Wilful Defaulter". This rather arbitrary diktat glosses over the distinct need to ascertain whether or not the bank in question had allowed the guarantor to step into the shoes of the borrower and take prior or subsequent ownership and possession of all securities that may have been offered, by the borrower, as collateral against his borrowing.

6. Can a bank function as a tribunal and adjudge its own matter? A recent judgement by the Hon'ble High Court of Delhi in *Punjab National Bank vs Kingfisher Airlines Ltd.* LPA 589/2014, CMs No.14796/2014 & 14798/2014 dated 17 December 2015, held that the bank Committee, constituted to decide on naming someone as a Wilful Defaulter, is a Tribunal within the meaning of Section 30 of the Advocates Act which reads as follows:

> 30. Right of advocates to practise.—Subject to provisions of this Act, every advocate whose name is entered in the State roll shall be entitled as of right to practise throughout the territories to which this Act extends—
>
> (i) in all courts including the Supreme Court;
>
> (ii) before any tribunal or person legally authorised to take evidence; and
>
> (iii) before any other authority or person before whom such advocate is by or under any law for the time being in force entitled to practise.

While the High Court ruling does enable a borrower to be represented by his counsel before the bank Committee, it would seem to be at considerable variance with the definition of a Tribunal as laid down in *Durga Shankar Mehta vs Raghuraj Singh*, AIR 1954 SC 520 namely:

> "It is now well settled by the majority decision of this Court in the case of Bharat Bank Ltd. v.

> Employees of the Bharat Bank Ltd. (1) that the expression 'Tribunal' as used in article 136 does not mean the same thing as 'Court' but includes, within its ambit, all adjudicating bodies, provided they are constituted by the State and are invested with judicial as distinguished from purely administrative or executive functions.

A Committee that is set up under a Circular issued by the RBI can perhaps not be construed as being the same as bodies that "are constituted by State and are given judicial powers". The RBI may well be regarded as State for the purposes of administrative law and monetary policy but that premise can hardly be extended to the RBI vesting one party in a commercial relationship (the bank) with quasi judicial authority.

In a similar vein, the Supreme Court in *Harinagar Sugar Mills vs Shyam Sunder Jhunjhunwala*, AIR 1961 SC 1669 gave out:

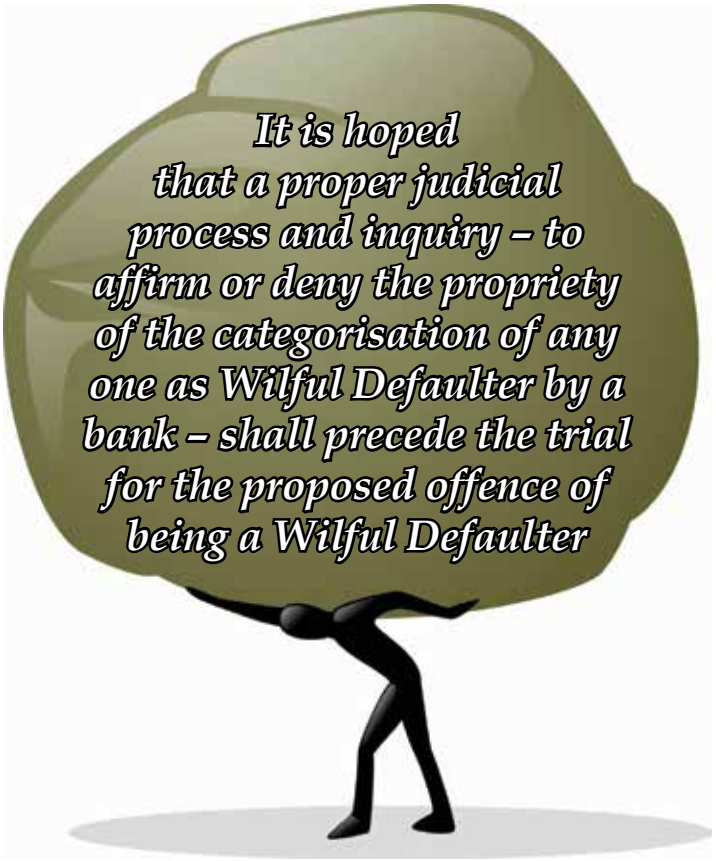
> "A decision of a tribunal on a dispute inter pares, in the light of pleadings and evidence, is essentially a judicial one, and this Court ought to be able, on the same material, to decide in an appeal whether the decision given was correct. If no substantive law is applicable, there are questions of evidence, of burden and adequacy of proof and of the application of the principles of justice, equity and good conscience to guide the Court and this Court ought to be able, on the same material, to decide in an appeal whether the decision given was correct."

It would be difficult to comprehend how the essential principles of justice, equity and good conscience would subsist in proceedings where the plaintiff (the bank in this case) also adjudicates the matter being thereby a judge in its own cause.

7. Given the very real – as opposed to remote – possibility that a borrower may be branded as a Wilful Defaulter by a bank despite the bank being responsible, in greater or lesser degree, for the debt having turned sticky, such a borrower would unjustly be subject to public opprobrium and humiliation besides being treated as a pariah by financial institutions. Not only would the name and particulars of the alleged Wilful Defaulter be circulated to banks, SEBI, CIBIL etc., these details can would also be liable to public disclosure through the mechanism of the Right to Information Act (RTI).

8. In a recent judgement viz. *Reserve Bank of India vs Jayantilal N Mistry*, Transferred Case (Civil) No. 91 of 2015 dated 16 December 2015,the Supreme Court(JJ Eqbal and Nagappan) upheld a decision of the CIC, inter alia, to the effect that:

> "The RBI would therefore be well advised to be proactive in disclosing information to the public in general and the information seekers under the RTI Act, in particular. The provisions of Section 10(1) of the RTI Act can therefore be judiciously used when necessary to adhere to this objective."



Armed with the above directive, any media person (or other private individual) can access and broadcast details of those whom banks classify as Wilful Defaulters without the affected party having had recourse, at any stage, to an independent adjudicator who would fairly apply the juridical principle of *audi alteram partem*'

9. There have been recent reports in the press that the IPC could be amended to render the act of being a Wilful Defaulter a punishable offence. It is hoped that a proper judicial process and inquiry – to affirm or deny the propriety of the categorisation of any one as Wilful Defaulter by a bank – shall precede the trial for the proposed offence of being a Wilful Defaulter.

In sum, therefore, it would appear that the current process of declaring someone to be a Wilful Defaulter and exposing him to direct and indirect penalties, on that account, needs thorough recasting so as to conform rigorously to the requirements of equity, natural justice and procedure established by law.

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