

## FAILURE TO HONOUR DUES UNDER DERIVATIVE CONTRACTS AMOUNTS TO 'WILFUL DEFAULT'

The Supreme Court, in decision of far reaching consequence (***Kotak Mahindra Bank v. Hindustan National Glass & Industries Limited***), has held that failure to honour payment obligations under a derivatives contract would amount to “wilful default” and will attract the provisions of the Master Circular on “Wilful Defaulters” dated July 2, 2012 issued by the RBI (**‘Master Circular’**). The Master Circular has been issued by RBI to collect and disseminate credit information about wilful defaulters. It is intended to ensure that such defaulters do not have access to further finance. A copy of the list of such wilful defaulters are also forwarded to SEBI and Credit Information Bureau (India) Ltd. (CIBIL) in order to ensure that the defaulters do not access capital markets in the future.

The decision arose from three different appeals from the decisions of the Bombay and Calcutta High Courts. The Calcutta High Court had held that default under a derivatives contract would not be within the purview of the Master Circular as there was no relationship of ‘lender’ and ‘borrower’ between the parties. On the other hand, the Bombay High Court had held that the Master Circular covers claims arising out of the foreign exchange derivative transactions.

After considering detailed arguments from all the parties, the Supreme Court held that the terms '**wilful default**' not only includes a wilful default in meeting one's repayment obligations to a lender, but also a default in meeting one's payment obligations to a bank under facilities such as a bank guarantee. The Court noted that the roots of the Master Circular can be traced to the instructions issued by Central Vigilance Commission which intended to collect information on defaulters. All cases of default of Rs.25 lakhs and above are required to be reported by the banks to the RBI and they are not merely limited to cases of defaults by borrowers of loans or advances from banks. Given the mischief that the Master Circular seeks to remedy, the Court held that default in meeting obligations under a derivatives contract would also be within the purview of the Master Circular.

***IndusLaw Quick View:*** The purposive interpretation undertaken in this decision is another bead in the series of decisions, whereby the apex court has adopted a pro-bank approach in applying traditional legislative provisions for new age financial transactions which extend much beyond the conventional lending and borrowing. With this decision the Master Circular on Wilful Default shall now have wider applicability with respect to all transactions involving banks whereby a default is made in any payment obligations.



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