

Corpsec Hotline

April 09, 2004

SECURITISATION ACT CONSTITUTIONALLY VALID BUT NOT SECTION 17(2): SAYS THE SUPREME COURT

In a landmark judgment, heralded as benefiting the Banks and borrowers, the Supreme Court on April 9, 2004 has upheld the validity of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**Securitisation Act**") and at the same time struck down the provision that required the borrowers to deposit 75 per cent of the amount claimed by lenders before they could file an appeal with the Debt Recovery Tribunals ("**DRT**"). The judgment was delivered by a Bench comprising Chief Justice V N Khare, Justice Brijesh Kumar and Justice Arun Kumar.

The Securitisation Act was passed in 2002 to give banks and Financial Institutions ("**FI**") more teeth to recover their bad assets. It is contemplated that the judgment may open the floodgates for litigation against the notices sent by banks and FIs to the borrowers under the Securitisation Act.

The background of the case was that, constitutionality of the Securitisation Act had been challenged by around 60 defaulting parties. In December 2002, all defaulting companies, which had challenged the Securitisation Ordinance (as it was then), were asked to move the Supreme Court and 60 Petitions were clubbed to be heard together. Specific challenge was also made on the validity of Section 17(2) of the Securitisation Act, which barred judicial remedies until the borrower deposited 75 per cent of the claim amount.

Section 17(2) of the Securitisation Act lays down that the DRT shall not entertain an appeal preferred by a borrower unless the borrower has deposited 75 per cent of the amount claimed in the notice with the DRT. Power had also been granted to the DRT to waive or reduce the amount to be deposited under the section.

The Supreme Court of India upheld the constitutionality of the Securitisation Act, but in a move to maintain the balance, struck down Sec 17(2). The Confederation of Indian Industry, while applauding the judgment, went on to state that if the borrower had the ability to pay 75 per cent, there would have been little likelihood of default in the first place.

*The Supreme Court upholding the constitutional validity of the Securitisation Act is a welcome move for the banks and FIs as it would enable them to make good their Non-Performing Assets ("**NPA**") by possessing and disposing of the assets of the defaulting borrowers. At the same time, borrowers are not faced with the burden of depositing huge amounts to pursue judicial remedies.*

You can direct your queries or comments to **Prashant Kataria & Vivek Kathpalia**

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