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Position of Secured Creditors not being Financial or Operational Creditor

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The Supreme Court in its recent judgement *Vistra ITCL (India) Ltd. and Ors. V. Dinkar Venkatasubramanian and Ors.*, discussed and clarified the treatment of a secured creditor who would not fall under the category of the financial creditor or operational creditor as per Insolvency and Bankruptcy Code, 2016 ("IBC"). While passing the judgement, the Apex Court explained the amendments carried out in IBC alongwith other various important related provisions under the IBC.

BRIEF FACTS OF THE CASE:

Amtek Auto Limited ("Corporate Debtor") approached appellants for a short-term loan facility of INR 500.00 crores for its group companies viz. Brassco Engineers Ltd. and WLD Investments Pvt. Ltd ultimately to be used by the Corporate Debtor. The loan was to be secured by pledging 16,82,06,100 equity shares of face value of INR 2/ each of JMT Auto Ltd. held by the Corporate Debtor.

Pursuant thereto, by executing pledge agreement on July 05, 2016, the Corporate Debtor pledged its 66.77% shares in JMT Auto Limited in favour of Vistra ITCL (India) Pvt. Limited for

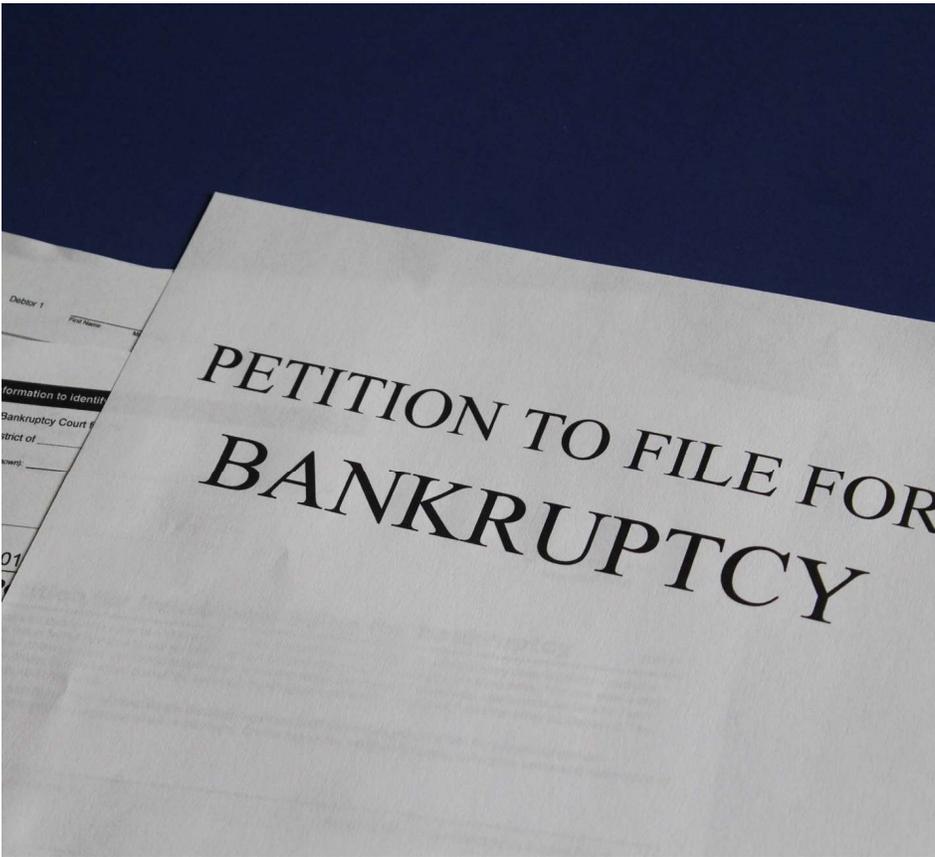
the benefit of KKR and L&T. Thereafter, an application for insolvency was admitted against the Corporate Debtor on July 24, 2017 and Mr. Dinkar T. Venkatasubramanian was appointed as the resolution professional.

The appellants filed a claim as a secured creditor of the Corporate Debtor, but it was rejected by the resolution professional, which order was not challenged by the appellants. Subsequently, the appellants filed another application under Section 60(5) of the IBC claiming rights based on the pledged shares. The Adjudicating Authority dismissed the said application, which was appealed to the NCLAT. The NCLAT dismissed the appeal, stating that the appellants claim in purported capacity of 'secured financial creditor' has already been rejected in year 2017 and could not be raised again in year 2020. Further, it was also stated that the appellants have not lent any money to the Corporate Debtor, therefore, they would not fall under the ambit of financial creditor of the Corporate Debtor.

The appellants aggrieved by the NCLAT decision, moved to the Hon'ble Supreme Court for seeking relief in their favour and preferred the appeal.



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due implementation of the terms of the Pledge agreement.

After the detailed analysis of various provisions of IBC and Indian Contract Act, the Apex Court briefed out 2 amicable solutions to the issues involved in the present case. The first solution suggested was to treat the Appellant as a financial creditor of the Corporate Debtor, specifically with regards to the estimated value of the pledged shares on the date when the corporate insolvency resolution process commenced entitling it to become a member of the CoC and granting it the voting rights equivalent to the estimated value of the pledged shares. However, the solution was not feasible since the resolution plan had already been approved by the CoC without Appellant. Further it was also highlighted that this solution may require reconsideration of the rulings in the cases of Anuj Jain (Supra) and Phoenix ARC (Supra), which would necessitate a reference to a larger bench.

JUDGEMENT

The Hon'ble Supreme Court had two issues to resolve viz. whether the appellant shall be considered as financial creditor or operational creditor of the corporate debtor; and whether the resolution plan can dilute, negate or override the pledge agreement because a resolution plan has been approved by the committee of creditors.

While resolving this predicament, the Apex Court explained the amendment/substitutions made in several provisions of the IBC in year 2019 with retrospective effect from June 06, 2018. Amended provisions of Section 30(2) of IBC were referred, wherein the said section ensures that the amount payable to the operational creditor under the

resolution plan and financial creditor voted against the resolution plan, should not be less than the amount payable to them, in the case of liquidation of the corporate debtor under Section 53 of the IBC. The resolution professional and the adjudicating authority are bound to protect the interest of the operational creditor and financial creditor voted against the resolution plan in accordance with provisions of Section 30(2) read with Section 31 of the IBC.

In the instant case, the Appellant being a secured creditor would not fall under the ambit of the financial creditor or operational creditor in accordance of the decision made by the Court in case of Anuj Jain (Supra) and Phoenix ARC (Supra), and thus per se shall not be entitled in law seek insistence on

Therefore, the Apex Court moved to its second preferred solution wherein, Appellant is to be treated as a secured creditor under Sections 52 and 53 of the IBC. This would allow Appellant to retain the security interest in the pledged shares and receive the proceeds from the sale of these shares, as per Section 52 of the IBC and Rule 21-A of the Liquidation Process Regulations.

Further, the Apex court clarified that the directions given in the preceding paragraph should not be used as grounds for the successful resolution applicant-DVI, to withdraw the already approved resolution plan. The reason for this is that any resolution plan must comply with the provisions of the Code and other applicable laws. The directions



and option provided in the previous paragraph ensure that the resolution plan adheres to the requirements of the Code and does not infringe upon the rights of the secured creditor, who should not be treated as inferior to other creditors, such as operational creditors or dissenting financial creditors.

CONCLUSION

Considering the second solution to be fair and just to resolve the legal conundrum and issue at hand, the Apex Court clarified that resolution plan should adhere the requirements of the IBC and shall ensure that it does not infringe upon the rights of the secured creditor, who should not be treated as inferior to other creditors, such as operational creditors or dissenting financial creditors.

The above judgment in view of the due recognition of the right of secured creditor vis-à-vis the security interest shall indeed empower the lenders in banking and finance transactions to also seek its right as a secured creditor in case of a resolution process of a pledgor (ordinarily the promoters of the borrowers). The lenders/ secured creditors/ financial creditors of the borrower company, in addition to calling an event of default under the financing documents of the borrower company shall also be legally entitled to participate in the resolution process of the pledgor and derive value out of the security interest which was earlier reduced to Nil. The judgement in the said background has indeed brought back the sanctity associated with 'security interest' and provides a sigh of relief to the lenders. [W](#)



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