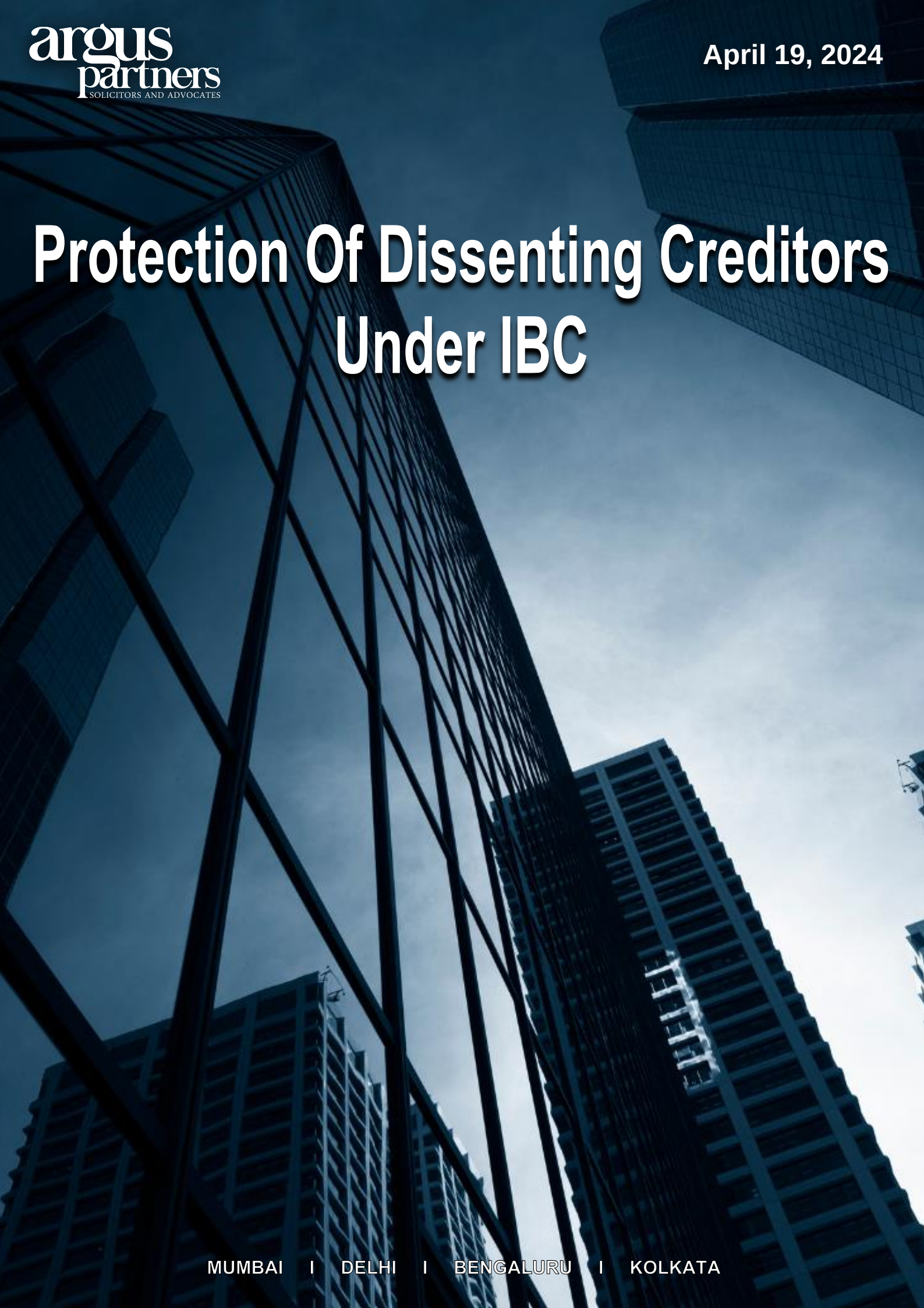
argus partners
SOLICITORS AND ADVOCATES

April 19, 2024

Protection Of Dissenting Creditors Under IBC



MUMBAI | DELHI | BENGALURU | KOLKATA

Table of Contents

I. Introduction

Under the Insolvency and Bankruptcy Code, 2016 ("**IBC**"), a resolution plan for a corporate debtor may be approved if 66% (sixty six percent) of the creditors forming part of the committee of creditors ("**CoC**") vote in favour of such plan.[1] So, even if a resolution plan has not been approved unanimously, but has been approved by the aforesaid requisite majority, such plan is binding on all stakeholders, including the creditors who did not vote in favour of the plan.[2]

The 'cram down' of a resolution plan on dissenting creditors is not a new construct and in certain jurisdictions such as the United States of America, this practice has been prevalent for decades.[3] To balance the harshness of this right of the majority, the standard international practice has been to build in several protections in the substantive law for the minority dissenting creditors.

In light of the above, it becomes imperative to examine the degree of protection offered to dissenting creditors under IBC and to evaluate whether the same is at par with the present international standards.

II. Legislative Overview

Fundamentally, 2 (two) key safeguards have been provided under IBC for dissenting financial creditors: *firstly*, under Section 30(2)(b) of IBC, such creditors are entitled to receive amounts "*which shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) of section 53 in the event of a liquidation of the corporate debtor*" in a fair and equitable manner[4]; and s*econdly*, under Regulation 38(1) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**CIRP Regulations**") such creditors have the right to be paid in priority over those members of the COC who voted in favour of the resolution plan.

Further as per Section 30(4) of IBC, while determining the viability and feasibility of a resolution plan, the CoC may also consider the waterfall of priority laid down in Section 53(1) of IBC (i.e., in a liquidation scenario), along with underlying value of the security held by the secured creditors.

Hence, the entitlement of dissenting creditors in the corporate insolvency resolution process ("**CIRP**") of a corporate debtor has been linked to amounts that such creditors would have received, in the hypothetical situation of the corporate debtor being liquidated. It may be pertinent to note that, in liquidation proceedings of a corporate debtor under IBC, a secured creditor who has relinquished its security to the liquidation estate instead of realising its security outside of the liquidation estate[5], gets a higher priority in the distribution waterfall of liquidated assets.[6]

III. Key Judicial Decisions

In a landmark judgement of the Supreme Court of India ("**Supreme Court**") in the case of *Committee of Creditors of Essar Steel India Limited* v. *Satish Kumar Gupta and Ors.*[7] ("**Essar Steel Judgement**"), a 3 (three) judge bench of the Supreme Court, while upholding the constitutional validity of the amendments made to Section 30(2) of IBC, *inter-alia*, observed that this provision was beneficial for dissentient financial creditors, as such creditors would be entitled to receive a certain minimum amount in CIRP. The Supreme Court also held that the decision to approve a resolution plan ultimately depends on the commercial wisdom of the CoC, and that the word "may" included in Section 30(4) of IBC implied that the CoC has been granted a discretion as to look at

[1] See section 30(4) of IBC.
[2] See section 31(1) of IBC.
[3] See 11 U.S.C. § 1129(b).
[4] Inserted by the Insolvency and Bankruptcy Code (Amendment) Act, 2019, w.e.f. August 16, 2019.
[5] See section 52 of IBC.
[6] See section 53 (b) and (e) of IBC.
[7] *Committee of Creditors of Essar Steel India Limited* v. *Satish Kumar Gupta*, (2020) 8 SCC 531.

certain considerations while approving a resolution plan (i.e., value of security, order of priority, etc.).

Subsequently, the Supreme Court in *Jaypee Kensington Boulevard Apartments Welfare Association* v. *NBCC (India) Limited Ors*.[8] ("**Jaypee Kensington Judgement**"), while deliberating on rights of dissentient financial creditors under IBC, relied on the Essar Steel Judgement and held that the resolution plan would be deemed to be in compliance with the provisions of Section 30(2) of IBC, if either actual payment of the requisite amount was made to a dissenting financial creditor, or, if such creditor was permitted to recover such money by enforcing its security interest.

Thereafter, a division bench of the Supreme Court in the case of *India Resurgence Arc Private Limited* v. *Amit Metaliks Limited*[9] ("**Amit Metaliks Judgement**") considered a key issue regarding the actual quantum of the amount payable to a dissenting financial creditor under a resolution plan. The contention raised by the appellant in this case was, that the approved resolution plan offered a payment of approximately Rs. 2,00,00,000 (Rupees two crore) to the appellant (who was a dissenting financial creditor), without considering the valuation of the security held by the appellant, which was valued at more than Rs. 12,00,00,000 (Rupees twelve crore). The Supreme Court, while relying on the Essar Steel Judgement and the Jaypee Kensington Judgement, upheld the discretionary nature of the considerations provided in Section 30(4) of IBC and observed that, so long as creditors of a particular class were being accorded a fair and equitable treatment under the resolution plan, the commercial wisdom of the CoC in approving or rejecting a resolution plan would reign supreme. Accordingly, an approved resolution plan which provided for distribution amongst the secured creditors (including dissentient secured creditors) in proportion to their respective admitted claims in CIRP/ voting share in the CoC was considered by the Supreme Court to be fair and equitable, and the contention that a dissenting secured creditor should be paid a higher amount basis the value of security held by such creditor was dismissed.

The view taken by the Supreme Court in the Amit Metaliks Judgement and followed by the National Company Law Tribunals ("**NCLTs**") and National Company Law Appellate Tribunal ("**NCLAT**") in the various cases thereafter, further postulates that Section 53(1) of IBC does not contemplate any hierarchy among the lenders as per the value of their security interest, but instead mandates that distribution be made to the secured creditors in the proportion of their outstanding debt. [10]

More recently, in the case of *DBS Bank Limited, Singapore* v. *Ruchi Soya Industries Limited*[11] ("**DBS Judgement**"), the question before a division bench of the Supreme Court was as follows:

> "*Whether Section 30(2)(b)(ii) of the Insolvency and Bankruptcy Code, 2016, as amended in 2019, entitles the dissenting financial creditor to be paid the minimum value of its security interest?*"

Interestingly, in this case the Supreme Court answered the aforesaid question in the affirmative, thereby taking a dramatically divergent view from the ruling pronounced in the Amit Metaliks Judgement. The Supreme Court observed that, while the CoC has the discretion to determine the manner of distribution of proceeds, however, Section 30(2)(b) of IBC should not be interpreted in such a manner so as to "*nullify the minimum entitlement*" of a dissenting financial creditor, as this provision provides protection to the dissenting financial creditor from being coerced into accepting

[8] *Jaypee Kensington Boulevard Apartments Welfare Association* v. *NBCC (India) Ltd*, (2022) 1 SCC 401.
[9] *India Resurgence Arc Private Limited* v. *Amit Metaliks Limited*., 2021 SCC Online SC 409.
[10] See: *ICICI Bank Limited* v. *BKM Industries Limited*, NCLAT, Company Appeal no. 405 of 2023; *Small Industries Development Bank of India (SIDBI)* v. *Vivek Raheja,* NCLAT, Company Appeal no. 570 of 2023; *Oriental Bank of Commerce* v. *Atlantic Projects Limited*, NCLT, 2023 SCC OnLine NCLT 1379; *Jet Aircraft Maintenance Engineers Welfare Associate* v. *Aashish Chhawchharia, RP of Jet Airways (India) Ltd.*, 2022 SCC OnLine NCLAT 418 and upheld by the Supreme Court in Civil Appeal No. 407 of 2023.
[11] *DBS Bank Limited, Singapore* v. *Ruchi Soya Industries Limited*, (2024) 1 S.C.R. 114.

a lower amount under a resolution plan *vis-à-vis* the amount that such creditor would have received had the corporate debtor been liquidated.[12]

However, in light of the contradictory views taken by the Supreme Court in the Amit Metaliks Judgement and the DBS Judgement, the matter has been referred to a larger bench.

IV. The International Perspective

While we await clarity on the aforesaid issue from the Supreme Court, it may be useful to refer to the rights of dissenting secured creditors and the protections being offered to such creditors under the laws prevailing in some select jurisdictions.

USA

Chapter 11 of the United States Bankruptcy Code ("**Bankruptcy Code**") lays down a set of essential conditions that have to be complied with, in order for the court to confirm a plan of reorganization.[13] Paragraph 7 of § 1129(a) of the Bankruptcy Code, *inter-alia*, states that each member of an accepting class should have either: (i) accepted the plan of reorganization; or (ii) received or retained under the plan, "*property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date*"[14] (emphasis supplied). It may be noted, under the Bankruptcy Code, a secured creditor has a right to receive the value of its collateral, up to the outstanding debt owed to such creditor.[15]

Further, the Bankruptcy Code provides that a plan of reorganization cannot be 'crammed down' (or made binding) on a dissentient class of secured creditors, unless such plan is fair and equitable, namely: (i) such secured creditors are entitled to retain their liens and receive deferred payments aggregating to the allowed amount of the secured claim, having a present value equal to the value of their collateral; (ii) liens of the creditor have been attached to the proceeds of sale of the secured property; or (iii) such creditors get the 'indubitable equivalent' (i.e. unquestionable value) of such secured claims.[16]

United Kingdom

Section 901G of the Companies Act, 2006[17] ("**UK Companies Act**") provides that a compromise or an arrangement under Part 26A of the UK Companies Act, would be binding on a dissenting class: (i) if "*none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative*"[18], i.e. liquidation, winding up, administration, etc.; and (ii) such compromise or arrangement has been accepted by at least 1 (one) class of creditors or members who would have received payments in the event of the relevant alternative.[19] It may be pertinent to note that under the Insolvency Act, 1986, read with the Insolvency (England and Wales) Rules, 2016, in an administration, winding up or bankruptcy, a secured creditor has the option to: (a) rely on its security entirely, or (b) value its security and prove for the balance debt, or (c) surrender its security and prove for the whole of the creditor's debt (as an unsecured debt).[20]

---

[12] *Also see: Export-Import Bank of India and Ors.* v. *Eastern Silk Industries Pvt. Ltd. and Ors.*, NCLT Kolkata, order dated January 31, 2024.
[13] 11 U.S.C. § 1129(a).
[14] 11 U.S.C. § 1129(a)(7)(A). Also see 11 U.S.C. § 1129(a)(7)(B).
[15] 11 U.S.C. § 506. Also see Lucian Arye Bebchuk and Jesse M. Fried, *A New Approach to Valuing Secured Claims in Bankruptcy*, Discussion Paper No. 321 04/2001, Harvard Law School, Cambridge.
[16] 11 U.S.C. § 1129(b).
[17] Inserted by the Corporate Insolvency and Governance Act, 2020.
[18] UK Companies Act, Section 901G (4) defines a 'relevant alternative' as "*whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned under section 901F*".
[19] UK Companies Act, Section 901G.
[20] Insolvency (England and Wales) Rules, 2016, Rule 14.19.

Singapore

Section 70 of the Insolvency, Restructuring and Dissolution Act 2018 ("**Singapore IRDA**") provides for the power of the court to cram down a compromise or an arrangement on a class of dissenting secured creditors, *inter-alia,* subject to the compromise or arrangement being fair and equitable, i.e.: (i) such creditor receives an amount under such compromise or arrangement, that is not lower than the amount that such creditor would have received "*in the most likely scenario if the compromise or arrangement does not become binding*" [21]; and (ii) the creditor is entitled to any of the options stated in Section 70(4)(b)(i) of the Singapore IRDA, which are similar to the options provided under § 1129(b)(2)(A) of the Bankruptcy Code.

V. The Outlook

From a review of the laws prevalent in the aforesaid jurisdictions, it appears that a fundamental principle that is being followed in bankruptcy laws globally, is that a dissenting secured creditor has a right to receive the value of its security, up to the amount due to such creditor. Hence, the view taken by the Supreme Court in the DBS Judgement seems to be in parity with the protection being offered to dissenting secured creditors globally.

It may be noted that a discussion paper was floated by the Insolvency and Bankruptcy Board of India ("**Board**") on November 1, 2023[22], whereunder certain amendments were proposed to the CIRP Regulations, including amendments to Regulation 38 *vis-à-vis* minimum entitlement of dissenting financial creditors. However, no clarity was provided in the said discussion paper with respect to the issue at hand. While, the IBBI (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations, 2024 were notified by the Board on February 15, 2024, the aforementioned proposed amendments to Regulation 38 with respect to the entitlement of dissenting financial creditors were not notified and have been held for further examination.[23]

In financing transactions today, creditors undertake extensive due diligence exercises and negotiations to arrive at a security package, on the basis of which credit calls are taken to advance loans/ financial facilities to borrowers. During CIRP, to deprive such creditors of the benefit of such collateral, would in our view, unfairly affect their interests and not be at par with the globally acceptable standards.

As noted above, in case of liquidation proceedings, secured creditors have the option to enforce security outside of the liquidation estate, however no such option has been made available in case of a CIRP. If secured creditors are being deprived of this right, there may be impetus by secured creditors to push the corporate debtor towards liquidation and not revival.

Therefore, in light of the coercive nature of cramdown provisions which essentially impose the views of the majority CoC on the minority, the legitimate expectations of dissenting secured creditors should be protected by ensuring that they receive an amount equivalent to the economic interest of their security under a resolution plan.

---

[21] Singapore IRDA, Section 70 (3) and 70(4)(a).

[22] '*Discussion paper on amendments to Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Process) Regulations, 2016*', can be accessed at https://ibbi.gov.in/uploads/whatsnew/b70daeb0fbec8cc61d1afc52e9e9fbb8.pdf.

[23] 'Gist of public comments on Discussion Paper on CIRP', can be accessed at https://ibbi.gov.in/uploads/public_comments/CIRP-Comments-on-Comments_approved-01-11-2023.pdf.

Recent Papers/ Articles

March 2024

AI & Copyright
Technology and Data Privacy

November 2023

Green Hydrogen (Series 2) - A Practical Insight Into Green Hydrogen Project Development
Energy and Infrastructure

November 2023

Angel Tax And The (Un)Ease Of Doing Business In India
Corporate and M&A, Private Equity & Venture Capital

August 2023

The Exclusive Jurisdiction of Courts regarding Wills - Scope for arbitration/ mediation of disputes arising out of a Will
Disputes

July 2023

Green Hydrogen (Series 1) : Framework And Developments In India
Energy and Infrastructure

May 2023

Regulating AI
Technology and Data Privacy

For more Papers/ Articles click here.

Contributed by:

Nidhi Arya
Partner

DISCLAIMER

You can send us your comments at:

knowledgecentre@argus-p.com

Mumbai I Delhi I Bengaluru I Kolkata

www.argus-p.com

MUMBAI
11, Free Press House
215, Nariman Point
Mumbai 400021
T: +91 22 6736 2222

DELHI
7A, 7th Floor, Tower C, Max House,Okhla Industrial Area,
Phase 3, New Delhi 110020
T: +91 11 6904 4200

KOLKATA
Binoy Bhavan
3rd Floor, 27B Camac Street
Kolkata 700016
T: +91 33 40650155/56

BENGALURU
68 Nandidurga Road
Jayamahal Extension
Bengaluru 560046
T: +91 80 46462300