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Anuj Jain Interim Resolution Professional for Jaypee Infratech Ltd. v. Axis Bank Limited & Ors.

Citation	**Civil Appeal Nos. 8512-8527 of 2019**
Date	**26 February 2020**
Court	**Supreme Court of India**
Bench	**Justice A.M. Khanwilkar and Justice Dinesh Maheshwari**

BACKDROP:

- As mentioned in the first part of the note on this Judgment, two of the most important aspects of the Insolvency and Bankruptcy Code, 2016 ('IBC') has been clarified by the Hon'ble Supreme Court in this Judgment laying down the laws relating to the Preferential Transaction as provided under section 43 and 44 of the IBC as well as law relating to the definition of 'Financial Creditor' and 'Financial Debt' as defined under section 5(7) & 5 (8) of the IBC. The first part of the note dealt with the law laid down in respect of the Preferential Transactions whereas this part deals with the aspect relating to the concept and definition of 'Financial Creditor' and 'Financial Debt' as defined under the provisions of the IBC and elucidated by the Hon'ble Court.
- Jaypee Infratech Limited ('JIL') mortgaged its properties as collateral securities for the loans and advances made by the lender banks and financial institutions to Jaiprakash Associates Limited ('JAL'), the holding company of JIL. Around 2016-17 subsequent re-execution of mortgage deeds were executed in respect of the properties of JIL to reflect the increase in the amount of facilities granted to JAL.
- On 09.08.2017,[1] the Learned National Company Law Tribunal, Bench at Allahabad ('NCLT') initiated the corporate insolvency resolution process ('CIRP') in respect of JIL. The lenders of JAL submitted a claim as a 'financial creditor' of JIL on the basis of the existence of the afore-referred mortgage deeds ('Said Transaction'). Resolution Professional ('RP') not only rejected the claim of the lenders of JAL and refused to recognize them as '*Financial Creditor*' of JIL; but, also filed an application seeking avoidance of these transactions as being preferential, undervalued and fraudulent in terms of Sections 43, 45 and 66 of the IBC on the ground that the subsequent re-executions of mortgage deeds were within look back period of two years.
- Two of the lenders of the JAL, i.e. ICICI Bank Limited and Axis Bank Limited ('Said Lenders') by way of separate applications under Section 60(5)[2] of the Code, questioned

[1] Company Petition (IB) No. 77/ALD/2017

[2] Section 60 of the IBC provides as follows:

"**60. Adjudicating Authority for corporate persons.** –

(1) The Adjudicating Authority, in relation to insolvency resolution and liquidation for corporate persons including corporate debtors and personal guarantors thereof shall be the National Company Law Tribunal having territorial jurisdiction over the place where the registered office of a corporate person is located.

(2) Without prejudice to sub-section (1) and notwithstanding anything to the contrary contained in this Code, where a corporate insolvency resolution process or liquidation 60 proceeding of a corporate debtor is pending before a National Company Law Tribunal, an application relating to the insolvency resolution or liquidation or bankruptcy of a corporate guarantor or personal guarantor, as the case may be, of such corporate debtor shall be filed before the National Company Law Tribunal.

(3) An insolvency resolution process or 2 [liquidation or bankruptcy proceeding of a corporate guarantor or personal guarantor, as the case may be, of the corporate debtor] pending in any court or tribunal shall stand transferred to the Adjudicating Authority dealing with insolvency resolution process or liquidation proceeding of such corporate debtor.

(4) The National Company Law Tribunal shall be vested with all the powers of the Debt Recovery Tribunal as contemplated under Part III of this Code for the purpose of subsection (2).

(5) Notwithstanding anything to the contrary contained in any other law for the time being in force, the National Company Law Tribunal shall have jurisdiction to entertain or dispose of –

the decision of IRP rejecting their claims to be recognized as financial creditors of the corporate debtor JIL on account of the securities provided by JIL for the facilities granted to JAL.

- The Learned NCLT rejected the applications filed by the Said Lenders, by way of its orders dated 09.05.2018 and 15.05.2018, respectively. Accordingly, the Learned NCLT rejected the application filed by the Said Lenders of JAL observing that:

  a. The Said Lenders had not disbursed the debt along with interest against the consideration for the time value of money, to JIL. It was specifically observed by the Learned NCLT that it is not the case of the Said Lenders that they have provided any 'debt' to JIL [as required under the various clauses of Section 5(8) of the IBC].

  b. By the mortgage created by JIL, as collateral security for the debt of its holding company JAL, in favour of the Said Lenders, they could not be treated as Financial Creditors of JIL.

  c. Hence, the Said Transactions did not qualify as '*financial debt*' qua JIL.

- Further, the Learned NCLT in its order dated 16.05.2018, has also accepted the application filed by the RP in part, holding that the Said Transactions were executed within the look back period of two years (before the commencement of the insolvency proceeding) and thus,

  a. six of the Said Transactions (out of total seven transactions that were challenged) were held to be preferential, undervalued and fraudulent within the meaning of Sections 43, 45 and 66 of the Code, and

  b. security interest was ordered to be discharged and the properties involved therein were vested back in JIL, with release of encumbrances.

- The Hon'ble National Company Law Appellate Tribunal ('NCLAT'),[3] vide Final Common Order dated 01.08.2019; took an entirely opposite view of the matter and upturned the order dated 16.05.2018 so passed by Learned NCLT, while holding that the transactions in question do not fall within the mischief of being preferential or undervalued or fraudulent; and that the lenders of JAL were entitled to exercise their rights under the Code as 'Financial Creditors' of JIL.

(a) any application or proceeding by or against the corporate debtor or corporate person;

(b) any claim made by or against the corporate debtor or corporate person, including claims by or against any of its subsidiaries situated in India; and

(c) any question of priorities or any question of law or facts, arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor or corporate person under this Code.

(6) Notwithstanding anything contained in the Limitation Act, 1963 or in any other law for the time being in force, in computing the period of limitation specified for any suit or application by or against a corporate debtor for which an order of moratorium has been made under this Part, the period during which such moratorium is in place shall be excluded."

[3] In Company Appeal (AT) (Insolvency) No. 353 of 2018 and Company Appeal (AT) (Insolvency) No. 301 of 2018

- Though, the aforesaid orders dated 09.05.2018 and 15.05.2018 were also questioned before the Hon'ble NCLAT by the Said Lenders of JAL by filing separate appeals (and the same formed part of the bunch of appeals decided by the Hon'ble NCLAT by way of the common Final Order dated 01.08.2019) and as per the final result recorded therein, these two appeals also stood allowed. However, nothing was discussed by Hon'ble NCLAT in the Final Order dated 01.08.2019 as regards the subject-matter of these two appeals i.e. as to whether the Said Lenders of JAL could be categorised as financial creditors of JIL or not. The conspectus of the Final Order dated 01.08.2019 including discussion and the final conclusion therein, only related to the Order dated 16.05.2018 that was passed by Learned NCLT on the application for avoidance filed by IRP. Aggrieved by this, the IRP, one of the creditors of JIL and the associations of home buyers (who have invested in the proposed projects of JIL) and JAL, preferred 4 appeals before the Hon'ble Supreme Court of India.

CONTENTIONS OF APPELLANT:

- In the background of the above facts, so far as question whether the Said Lenders of JAL could be classified as 'Financial Creditor' of JIL, the following contentions were raised by the Appellants:

  a. Appeals were allowed by Hon'ble NCLAT without recording any findings and without any discussion in that regard.

  b. It was contended by the appellants that as per sub-section (7) of Section 5 of the IBC, only such creditor could be the 'financial creditor' of the corporate debtor to whom a 'financial debt' is owed by the corporate debtor; and, as per sub-section (8) of Section 5 of the Code, the key requirement of a financial debt is 'disbursal against the consideration for the time value of money', which includes the events or modes of disbursement as enumerated in sub-clauses (a) to (i) of Section 5(8).

  c. The Said Lenders of JAL have no right to demand the mortgage money from JIL and that JIL was under no liability to pay the same. It was submitted that mere holding of security interest, which too had not been extended for direct disbursement of any credit to JIL, could not make the Said Lenders as financial creditors of JIL within the meaning of IBC.

  d. It was further contended that the definition of 'financial debt' extends to various types of transactions; yet it does not include a mortgage, as could be gathered from a plain and simple reading of the Section 5(8) of the IBC.

  e. It was contended that the Said Lenders of JAL could at best be construed as plain creditors, who are entitled to file Form F[4] and to specify their security interest in column 8 thereof; and in any case, they cannot become

[4] Form F is prescribed under Regulation 9A the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 as the Proof of Claim to be filed by Creditors other than Financial Creditors and Operational Creditors.

financial creditors of JIL.

f. On the concept of the guarantee, it was argued that the 'mortgage' cannot be deemed to mean 'guarantee', for a mortgagor has no intentions to undertake to discharge the liability of a third person in case of his default in repayment of debts.

g. It was contended that the liability always flows from debt and not from the security created under the mortgage.

h. Finally, it was contended that a secured creditor *ipso facto* does not become a financial creditor.

CONTENTIONS OF RESPONDENT:

- On the other hand, the Respondent on the said issue contended that:
  - **a.** Nature and character of a 'mortgage' is such that it secures a debt.
  - **b.** It was argued that a mortgage is both a promise by a debtor to repay the loan as well as a real property right; of course, the right being intended to secure the due payment of the debt; and a suit on a mortgage is essentially a suit for recovery of a debt.
  - **c.** It was contended that a mortgage debt is a 'debt' within the meaning of Section 3(11) of the Code and that a debt can be classified to be a debt due from 'any person' and not necessarily restricted to the borrower alone.
  - **d.** It was further contended that a third-party mortgagor, who mortgages the property to secure the financial obligation of another party, stands in the position of a guarantor and hence, the mortgagee is a financial creditor of the third-party mortgagor.
  - **e.** It was argued that the creation of mortgage undoubtedly is a 'security interest' as defined in Section 3(31) of the IBC in as much as a security interest includes any creation of right/ title/ interest/ claim in property, for the purpose of securing the payment or performance of an obligation; and also includes a mortgage.
  - **f.** On the definition of the 'Financial Debt' under Section 5(8) of the IBC has been given an extended meaning so as to include the situations which may not directly involve disbursal against the consideration for time value money.
  - **g.** Finally, it was argued that under Section 58 of the Transfer of Property Act, 1882 ('TOPA') that a mortgage presupposes the subsistence of a debt and hence it is a secured debt.

QUESTIONS ARISEN BEFORE THE HON'BLE SUPREME COURT:

- In the background of the above contentions, the essential question that arose before the Hon'ble Supreme Court was whether the Said Lenders of JAL could be recognized as 'financial creditors' of JIL on the strength of the mortgage created by it, as collateral security of the debts given by them to its holding company JAL.

FINAL ORDER:

- The Hon'ble Supreme Court in the Judgment[v] held that debts in question are in the form of a third-party security; said to have been given by JIL so as to secure the loans/ advances/ facilities obtained by JAL from the Said Lenders. It has now been held that such a 'debt' is not and cannot be a covered under the expression 'financial debt' [as defined under Section 5(8) of the IBC]; and hence, the Said Lenders (being the mortgagees) are not the 'financial creditors' of JIL.
- **It was held that in order to qualify as a 'financial creditor' a basic element of disbursal of amount against the consideration of time value of money must be there**. It was observed that it may partake in any form of transaction as envisaged under section 5(8) of the IBC; but disbursement to the corporate debtor, against the consideration for the time value of money remains an essential part.
- The Hon'ble Court while construing the meaning of the words 'mean' and 'include' as provided under section 5(8) of the IBC held that:

  a. the definition, by its very frame, cannot be read so expansive, rather infinitely wide; and

  b. that the root requirements of 'disbursement' against 'the consideration for the time value of money' could not be forsaken in the manner that any transaction could stand alone to become a financial debt.

- Therefore, it was held that the essential element of disbursal, and that too against the consideration for time value of money, needs to be found in the genesis of any debt being claimed as 'financial debt' before it may be treated as 'financial debt' within the meaning of Section 5(8) of the IBC.

- The Hon'ble Court also considered the definitions of the following expressions, which are extracted hereinbelow for ease of reference:

  a. 'debt' [as defined under Section 3(11)]:

  "*(11) "debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt;*"

  b. 'secured creditor' [as defined under Section 3(30)]; and

  "*(30) "secured creditor" means a creditor in favour of whom security interest is created;*"

  c. 'security interest' [as defined under Section 3(31)]:

  "*(31) "security interest" means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person: Provided that security interest shall not include a performance guarantee;*"

- It was on perusing the above definitions held that the legislature has maintained a distinction amongst the expressions 'financial creditor' and 'operational creditor' and 'secured creditor' and 'unsecured creditor'. Therefore, it was held by the Hon'ble Supreme Court that every secured creditor would be a creditor and every financial creditor would also be a creditor; but, every secured creditor may not be a financial creditor.

- The Hon'ble Court also considered the celebrated judgments on IBC passed by the Hon'ble Supreme Court itself i.e. *Swiss Ribbons Private Limited v. Union of India*[5] and *Pioneer Urban Pioneer Urban Land and Infrastructure Limited & Anr. v. Union of India and Ors.*[6] and held that what is intended by the expression 'financial creditor' is a person who has direct engagement in the functioning of the corporate debtor; who is involved right from the beginning while assessing the viability of the corporate debtor; who would engage in restructuring of the loan as well as in reorganisation of the corporate debtor's business when there is financial stress. Therefore, it was held that the financial creditor, by its own direct involvement in a functional existence of corporate debtor, acquires unique position, who could be entrusted with the task of ensuring the sustenance and growth of the corporate debtor, akin to that of a guardian. Therefore, it was concluded by the Hon'ble Court including the other creditors (especially the creditors having only security interest over the assets of the Corporate Debtor without there being any other involvement of disbursal of funds against the consideration of the time value of money) like the Said Lenders would defeat the objectives of the IBC.

- On the basis of the above finding, the Hon'ble Court ultimately held that the creditors of JAL cannot be included under the class of 'Financial Creditors' of JIL; merely on the basis of the execution of mortgage deeds.

QUESTIONS REMAINED UNANSWERED AND DIFFICULTIES POSED BY THE JUDGMENT:

- The Hon'ble Court has categorically held that the disbursal against the consideration of time value of money is the essential ingredient for any creditor to be under the definition of the 'financial creditor'. It thus poses a question that whether the invocation of the guarantee provided by the Corporate Debtor to discharge the debt of other company being the principal borrower would make the creditor invoking the guarantee as the 'financial creditor'?

- Though the Hon'ble Court has not traversed specifically in answering the said question straight away and has not interpreted each clause as encapsulated in the definition of section 5 (8) of the IBC (as the same did not arise in the said matter). But having said that, the reading the essence of the Judgment would suggest that the answer to this question would be a clear 'no' as there is no disbursal to the Corporate Debtor against the consideration of time value of money. The obvious upshot of the same is that the liability of the guarantor may be co-existent with that of the principal borrower; but

[5] Judgment dated 25.01.2019 in Writ Petition (C.) No. 99 of 2018 reported at (2019) 4 SCC 17.
[6] Judgment dated 09.08.2019 in Writ Petition (C.) No. 43 of 2019 reported at (2019) 8 SCC 416.

that would make the creditor invoking the guarantee as only a 'creditor' of the Corporate Debtor and not the 'financial creditor' as defined under section 5(7) read with 5(8) of the IBC.

- Therefore, the natural corollary of this interpretation is that neither such creditor having the security interest nor the creditors invoking guarantee can invoke the provisions of Section 7 of the IBC and applications filed by such creditors are liable to be rejected as not maintainable. Consequentially, such creditors cannot be a part of the Committee of Creditors ('CoC') constituted under Section 21[7] of the IBC. This

[7] Section 21 of the IBC provides as follows: "**21. Committee of creditors. –**

(1) The interim resolution professional shall after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors.

(2) The committee of creditors shall comprise all financial creditors of the corporate debtor:

Provided that a financial creditor or the authorised representative of the financial creditor referred to in sub-section (6) or sub-section (6A) or sub-section (5) of section 24, if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors:

Provided further that the first proviso shall not apply to a financial creditor, regulated by a financial sector regulator, if it is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares or completion of such transactions as may be prescribed, prior to the insolvency commencement date.

(3) Subject to sub-sections (6) and (6A), where the corporate debtor owes financial debts to two or more financial creditors as part of a consortium or agreement, each such financial creditor shall be part of the committee of creditors and their voting share shall be determined on the basis of the financial debts owed to them.

(4) Where any person is a financial creditor as well as an operational creditor, -

(a) such person shall be a financial creditor to the extent of the financial debt owed by the corporate debtor, and shall be included in the committee of creditors, with voting share proportionate to the extent of financial debts owed to such creditor;

(b) such person shall be considered to be an operational creditor to the extent of the operational debt owed by the corporate debtor to such creditor.

(5) Where an operational creditor has assigned or legally transferred any operational debt to a financial creditor, the assignee or transferee shall be considered as an operational creditor to the extent of such assignment or legal transfer.

(6) Where the terms of the financial debt extended as part of a consortium arrangement or syndicated facility provide for a single trustee or agent to act for all financial creditors, each financial creditor may-

(a) authorise the trustee or agent to act on his behalf in the committee of creditors to the extent of his voting share;

(b) represent himself in the committee of creditors to the extent of his voting share;

(c) appoint an insolvency professional (other than the resolution professional) at his own cost to represent himself in the committee of creditors to the extent of his voting share; or

(d) exercise his right to vote to the extent of his voting share with one or more financial creditors jointly or severally. (6A) Where a financial debt—

implies that they will have no right on the decision making involved during the CIRP and shall stand completely excluded.

- The said interpretation by the Hon'ble Court may seem to be obvious and plain; but, the consequences it carries are massive. There are many cases where the CIRP was initiated on the applications filed on behalf of the creditors only having security interest in the assets of the corporate debtor or upon invocation of the guarantee issued by the said corporate debtor. Furthermore, all such creditors have been a part of the CoC and have been deciding the fate of the Corporate Debtor during the CIRP. Many such companies have already gone into liquidation on behest of the decision making by such secured creditors.

- It thus creates a conundrum where if such secured creditors didn't fall under the definition of 'Financial Creditor', then all such actions taken by them could be construed to be illegal and non-est. Hence, in the wake of this judgment, we may see a new round of litigation where the actions of such creditors [having been taken as a

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(a) is in the form of securities or deposits and the terms of the financial debt provide for appointment of a trustee or agent to act as authorised representative for all the financial creditors, such trustee or agent shall act on behalf of such financial creditors;

(b) is owed to a class of creditors exceeding the number as may be specified, other than the creditors covered under clause

(a) or sub-section (6), the interim resolution professional shall make an application to the Adjudicating Authority along with the list of all financial creditors, containing the name of an insolvency professional, other than the interim resolution professional, to act as their authorised representative who shall be appointed by the Adjudicating Authority prior to the first meeting of the committee of creditors;

(c) is represented by a guardian, executor or administrator, such person shall act as authorised representative on behalf of such financial creditors, and such authorised representative under clause (a) or clause (b) or clause (c) shall attend the meetings of the committee of creditors, and vote on behalf of each financial creditor to the extent of his voting share.

(6B) The remuneration payable to the authorised representative- (i) under clauses (a) and (c) of sub-section (6A), if any, shall be as per the terms of the financial debt or the relevant documentation; and (ii) under clause (b) of sub-section (6A) shall be as specified which shall be form part of the insolvency resolution process costs.

(7) The Board may specify the manner of voting and the determining of the voting share in respect of financial debts covered under sub-sections (6) and (6A).

(8) Save as otherwise provided in this Code, all decisions of the committee of creditors shall be taken by a vote of not less than fifty-one per cent. of voting share of the financial creditors: Provided that where a corporate debtor does not have any financial creditors, the committee of creditors shall be constituted and shall comprise of such persons to exercise such functions in such manner as may be specified.

(9) The committee of creditors shall have the right to require the resolution professional to furnish any financial information in relation to the corporate debtor at any time during the corporate insolvency resolution process.

(10) The resolution professional shall make available any financial information so required by the committee of creditors under sub-section (9) within a period of seven days of such requisition."

consequence of them being treated as the 'financial creditor'] may be challenged. It would be interesting to see how such gaping questions are dealt by the concerned Tribunals/Courts, as and when they are faced with the same.