Rights of Secured Creditors under the Insolvency and Bankruptcy Code, 2016

The NCLAT recently in the matter of Mr. Srikanth Dwarakanath vs Bharat Heavy Electricals Limited [2020] ibclaw.in 176 NCLAT had allowed the appeal filed by Mr. Srikanth Dwarakanath, liquidator of Surana Powers Limited (SPL) against the impugned order passed by NCLT, Chennai and held that BHEL (one of the secured creditors) does not have the right to realize its security interest as the same would be detrimental to the liquidation process and the interest of the remaining ten secured creditors of Surana Powers Limited. BHEL had claimed exclusive rights over the secured assets of Surana Powers Limited through an arbitration award in its favour. Section 52 and 53 of the Insolvency and Bankruptcy Code, 2016 (IBC, Code) deal with the rights of the secured creditors.

Introduction

A secured creditor is defined under section 3(30) of IBC as a creditor in favour of whom security interest is created. The term “Security Interest” has also been defined under section 3(31) of the Code. It 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. However, the proviso to section 3(31) states that the term “Security Interest” does not include performance security.

A secured creditor is not allowed to enforce its security interest against the corporate debtor during the Corporate Insolvency Resolution Process (CIRP) in view of moratorium clause under section 14 of IBC. Section 14(1)(c) specifically provides that the Adjudicating Authority on insolvency commencement date, shall by order declare moratorium for prohibiting any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of property including any action under the SARFAESI Act, 2002. The rights of the secured creditors are restored only after the commencement of liquidation proceedings against the corporate debtor under section 33 of the Code. After the commencement of liquidation proceedings, a secured creditor can exercise any one of the following rights to recover its debt:

(i) Secured creditor can either relinquish its security interest to the liquidation estate under section 52(1)(a) or
(ii) The secured creditor can realize the security interest in the manner specified under section 52(1)(b).

**Effect of secured creditor’s rights under Section 52**

If the secured creditors relinquish their security interest under section 52(1)(a), they are placed 2nd under the waterfall mechanism right after the payment of insolvency resolution process costs and the liquidation costs. They are placed at par with “workmen's dues for 24 months preceding the liquidation commencement date” under section 53 of IBC. Upon relinquishment of the security interest by the secured creditors, the secured assets become part of liquidation estate of the corporate debtor and the liquidator can sell such assets under regulation 32 of Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.

And, if the secured creditors decide to realize their interest in the secured assets of the corporate debtor, such assets do not become part of the liquidation estate of corporate debtor. The secured creditors may enforce and realize their secured interest and apply the proceeds to recover their debt. However, in such case the secured creditors cannot sell or transfer the secured asset to any person, who is not eligible under the Code to submit a resolution plan for the insolvency resolution of the corporate debtor in terms of the recently introduced Regulation 37(8) of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016. The purpose of this amendment is to prevent the back-door entry of the otherwise ineligible resolution applicants into the management of the corporate debtor.

When the proceeds from the realization of the secured interest are not adequate to repay the debt owed to the secured creditors, the unpaid portion of the secured debt would be paid out of the liquidation estate at 5th position in the order of priority under S-53 of IBC after the payment to unsecured creditors. However, if the secured creditors have realized their security interest and proceeds are in excess of the debt due to the secured creditors, the secured creditors shall account to the liquidator any surplus funds received from the enforcement of such secured assets under section 52(9) of the Code.

Regulation 21A (2) of the Liquidation Process Regulations, 2016 provides that where the secured creditor proceeds to realize its security interest, it shall pay:

(a) The amount which would have been payable by the secured creditor for Insolvency Resolution Process Cost and Liquidation Costs, if it had relinquished its share to the liquidation estate within 90 days from the liquidation commencement date.

(b) The excess of the realised value of the secured asset over the amount of its claims admitted, to the liquidator within 180 days from the liquidation commencement date.

When the amount payable under this sub-regulation is not certain by the date on which the amount is payable, the secured creditor would pay the amount which is estimated by the liquidator and the difference between the amount payable under this sub regulation and the amount paid would be made good by the secured creditor or the liquidator, as the case may be, as soon as the amount payable under this sub-regulation is made certain and informed by the liquidator.

Regulation 21(3) provides that where a secured creditor fails to comply with sub-regulation (2), the asset, which is subject to security interest, would become part of the liquidation estate.
What would happen when the secured creditor fails to exercise any of the rights mentioned under section 52?

Regulation 21A of The (Liquidation Process) Regulations, 2016 provides that a secured creditor shall inform the liquidator of its decision to relinquish its security interest to the liquidation estate or realise its security interest, as the case may be, in Form C or Form D of Schedule II and where a secured creditor does not intimate its decision within thirty days from the liquidation commencement date, the assets covered under the security interest shall be presumed to be part of the liquidation estate.

What if there are more than one secured creditor having security interest over the same secured assets?

The NCLAT in the matter of JM Financial Asset Reconstruction Company Limited vs Finquest Financial Solutions Pvt. Ltd (2019 SCC Online NCLAT 918) had held that only one secured creditor can enforce its right for realization of the debt out of the secured assets because after the realization of security interest by one of the secured creditors under section 52(1)(b), it is bound under section 52(7) to deposit the excess amount by way of realized proceeds in the account of the liquidator and thus, no other secured creditor can enforce its right subsequently for realization of the amount from the same secured assets. If one or more secured creditors have opted to realize their security interest against the same very asset in terms of section 52(1)(b), the liquidator will act in terms of section 52(3) and find out as to who has the 1st charge on the secured assets from the records maintained by the information utility or in any other manner as may be specified by the Board and pass an appropriate order.

Jurisdiction of Adjudicating Authority/ NCLT in enforcing the security interest of secured creditors during liquidation proceedings

A secured creditor can file an application before Adjudicating Authority/ NCLT for realizing the security interest under section 52(5) of the Code only when it is facing any resistance from the corporate debtor or any person connected therewith while taking possession of, selling or otherwise disposing off the security as reiterated by NCLAT in this judgement. Otherwise, in the normal course, there is no provision to file any application before the Adjudicating Authority under section 52 for enforcement of any rights by the secured creditors.

Observations made by NCLAT in the present case

The NCLAT had observed that S-52(4) of IBC itself provides that the secured creditor may enforce, realize, settle, compromise or deal with the secured assets in accordance with such law as applicable to the security interest being realized and to the secured creditor and apply the proceeds to recover the debt due to it. The enforcement of security interest is governed under section 13 of the SARFAESI Act, 2002. Any step for the realization of assets by the secured creditors shall require confirmation from the creditors having at least 60% of the value of total debt under section 13(9) of the Act. The relevant provision is reproduced below:

"13 (9) :- Subject to the provisions of the Insolvency and Bankruptcy Code, 2016, in the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than [sixty per cent] in value of the amount outstanding as on the record date and such action shall be binding on all the secured creditors."

In conclusion, The NCLAT held that BHEL can exercise its right to realize the security interest over the assets of SPL
under section 52(1)(b) of IBC only in accordance with section 13(9) of SARFAESI Act, 2002 and since, it has only 26.24% security interest in the assets of the corporate debtor, it is bound by the decision of majority of secured creditors who have decided to relinquish their secured interest to the liquidation estate of the corporate debtor.

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