

Supreme Court Holds Inter Creditor Agreement Mandatory for Resolution of Debt Securities under RBI Directions

Dealing with the rights of the debenture holders and the manner in which listed debenture holders may participate in a resolution plan under the Reserve Bank of India (“RBI”) (Prudential Framework for the Resolution of Stressed Assets) Directions, 2019 (“RBI Directions”), the Supreme Court, on August 30, 2022, delivered its judgment in the case of *Securities and Exchange Board of India v. Rajkumar Nagpal & Others*¹. It held that the enabling framework provided under the Securities and Exchange Board of India (“SEBI”) circular dated October 13, 2020 on ‘Standardisation of procedure to be followed by Debenture Trustee(s) in case of default by Issuers of listed debt securities’ (“SEBI Circular”) is mandatory and that the inter-creditor agreement (“ICA”) must be entered into if the holders of debt securities were to avail of a resolution plan under the RBI Directions.

As set out below, the ruling makes it clear that the debenture holders are bound by the RBI Directions once they elect to enter into an ICA. There would be no option for the debt security holders to subsequently avail of a resolution plan formulated by the lenders under the RBI Directions if the ICA has not been entered into. Thus, other than the limited circumstances specified in the SEBI Circular, if election to enter into the ICA is made, then such debt security holders would also be bound by the majority approved resolution plan. This ruling, therefore, brings about greater certainty



in the formulation and implementation of a resolution plan under the RBI Directions.

Snapshot Of The RBI Directions And The SEBI Circular

The RBI Directions provide a framework for recognition and resolution of stressed assets through implementation of a resolution plan. The RBI Directions also require all lenders to enter into an ICA for the purposes of implementation of a resolution plan. Notably, the RBI Directions apply only to ‘lenders’ as specified in paragraph 3 of the said directions² and do not make any provision for other creditors such as debenture holders.

¹ 2022 SCC OnLine SC 1119.

² As per footnote number 1 to the RBI Directions, ‘lenders’ shall mean all entities mentioned at paragraph 3 of the RBI Directions, unless specified otherwise. Paragraph 3 of the RBI Directions provides that:

“Applicability”

The provisions of these directions shall apply to the following entities:

- Scheduled Commercial Banks (excluding Regional Rural Banks);
- All India Term Financial Institutions (NABARD, NHB, EXIM Bank, and SIDBI);
- Small Finance Banks; and
- Systemically Important Non-Deposit taking Non-Banking Financial Companies (NBFC-ND-SI) and Deposit taking Non-Banking Financial Companies (NBFC-D).”

The SEBI (Debenture Trustees) Regulations, 1993 (“**DT Regulations**”), *inter alia*, lay down the responsibilities and obligations of debenture trustees. The DT Regulations also prescribe the code of conduct to be followed by debenture trustees in case of issuance of listed debt securities. Regulation 15(7) of the DT Regulations also stipulates that subject to the approval of the debenture holders and the conditions as may be specified by the SEBI from time to time, the debenture trustee, on behalf of the debenture holders, may enter into ICAs provided under the framework specified by the RBI. The SEBI Circular, which came into effect on October 13, 2020, *inter alia*, provides a detailed mechanism for investors in listed debt securities³ to sign the ICA, as contemplated in the RBI Directions, to avail the benefit of a resolution plan approved and implemented as per the RBI Directions. The SEBI Circular prescribes the approval of not less than 75% of the debenture holders by value of the outstanding debt and 60% of the debenture holders by number at the international security identification number (“**ISIN**”) level for the purposes of entering into the ICA by the debenture holders under the RBI Directions.

Brief Background

In the present case, the lenders of Reliance Commercial Finance Limited (“**RCFL**”) had entered into an ICA and approved a resolution plan in terms of the RBI Directions. Thereafter, in view of the negotiated settlement between the parties, the resolution plan under the ICA was modified to provide payments to the debenture holders of RCFL. The resolution plan was to be placed before the debenture holders for their approval. Consequently, the following key questions arose: (i) whether it is mandatory for debenture holders to enter into the ICA, in case they seek to participate in a resolution plan under the RBI Directions; (ii) whether the SEBI Circular would be applicable to defaults committed prior to October 13, 2020 (i.e., the date on which the SEBI Circular came into effect).

Key Issues Decided By The Supreme Court

On appeal, while the Supreme Court exercised its powers under Article 142 of the Constitution to uphold the resolution plan agreed upon by the parties in light of the peculiar facts and circumstances of the case, the Supreme Court dealt with and decided the following substantive issues of law:

a. Mandatory to enter into ICA in case debenture holders opt to participate in a resolution plan

The Supreme Court noted that if the lenders opt to participate in a resolution plan as per the RBI Directions, then they are mandated to enter into an ICA in terms of paragraph 10 of the RBI Directions. It further noted that entering into an ICA is a *sine qua non* for implementation of a resolution plan under the RBI Directions.

In this light, the Supreme Court rejected the contention of RCFL that the debenture holders may opt for the resolution plan after it has been formulated, without first entering into an ICA as per the procedure set out in the SEBI Circular. The Supreme Court stated that while the language of the SEBI Circular is facilitative and not mandatory in nature (i.e., it does not make the RBI Directions binding on holders of listed debt securities), it cannot be construed to be facilitative in terms of enabling the debenture holders to circumvent the modalities prescribed by the SEBI Circular in the event they seek to participate in a resolution plan under the RBI Directions.

b. The SEBI Circular has retroactive application

The Supreme Court held that the SEBI Circular has ‘retroactive’ and not ‘retrospective’ application, as the SEBI Circular does not operate backwards and does not extinguish or affect vested rights, but rather it operates in future and its operation is premised upon events

³ As per Regulation 2(1)(k) of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021, “*debt securities*” means *non-convertible debt securities with a fixed maturity period which create or acknowledge indebtedness and includes debentures, bonds or any other security whether constituting a charge on the assets/properties or not, but excludes security receipts, securitized debt instruments, money market instruments regulated by the Reserve Bank of India, and bonds issued by the Government or such other bodies as may be specified by the Board.*”

which happened in the past or requisites which had been drawn from antecedent events.

The Supreme Court held that as of October 13, 2020, a compromise or agreement on the restructuring of the debt owed by RCFL did not exist, and the debenture holders were not vested with any rights with respect to the resolution of RCFL's debt. The existence of the debt and the subsequent default by RCFL were the status of events, which existed prior to October 13, 2020. Thus, on the SEBI Circular coming into effect, the modalities prescribed under the SEBI Circular would override the provisions of the debenture trust deeds (“DTDs”).

Further, the Supreme Court held that even assuming that the debenture holders were vested with the right to approve a compromise or arrangement in terms of the voting mechanism provided under the DTDs, they were divested of such a right upon the issuance of the SEBI Circular. The Supreme Court held that the SEBI Circular has a statutory character (given that the same has been issued in exercise of the powers under, *inter alia*, the DT Regulations), and a contractually vested right may be divested by the operation of a statutory instrument. Accordingly, rights to block a resolution, if any, under the DTD will be overridden by the SEBI Circular.

Further, it may be noted that the Supreme Court, in support of its finding, also relied on a specific contractual term in the DTD, which provided that any provision in the DTD in conflict with the DT Regulations would be null and void. Consequently, the Supreme Court held that the SEBI Circular would take precedence over the terms of the DTD.

c. The SEBI Circular binds dissenting debenture holders at ISIN level

The Supreme Court held that similar to the scheme of Section 230 of the Companies Act, 2013 and the RBI Directions, where the laws bind the dissenting creditors, the SEBI Circular would also bind dissenting debenture holders at the ISIN level.

Further, noting the concern in respect of ISIN level voting having the potential to frustrate a resolution plan by allowing a single debenture holder (holding an entire ISIN or more than one ISIN) to prevent the creditors from arriving at an ICA or a resolution plan, the Supreme Court held that the same cannot be taken

into account to determine the applicability of the SEBI Circular. However, the Supreme Court left it open to the relevant stakeholders to approach the SEBI with any concerns and request an amendment to the SEBI Circular.

Concluding Remarks

The judgment of the Supreme Court has made it amply clear that as far as holders of listed debt securities are concerned, any adoption of a resolution plan under the RBI Directions can be done only after entering into an ICA as per the voting thresholds provided under the SEBI Circular. The fact that the default may have occurred prior to the date of the SEBI Circular coming into effect, is immaterial. The Supreme Court has further held that the SEBI Circular, having statutory character, would override any contractually agreed term between the parties. The Supreme Court held that even though the SEBI Circular is facilitative in nature, the modalities prescribed therein would be mandatorily applicable should the debenture holders seek to participate in a resolution plan under the RBI Directions.

The decision of the Supreme Court advances the object of a comprehensive debt resolution process by ensuring that a harmonised and holistic framework is available to the lenders under the RBI Directions and the holders of listed debt securities. The ruling ensures that a duly approved resolution plan is not derailed at a later stage due to its non-adoption by holders of debt securities. While it is always open for the debenture holders to stay out of a resolution under the RBI Directions by not becoming parties to the ICA, the decision clarifies the demarcation between participants and non-participants to the resolution process at the threshold itself, bringing certainty in the outcome and implementation of a duly approved resolution plan.

However, the challenges and practical difficulties of ISIN level voting, as provided under the SEBI Circular, do pose certain concerns in respect of materialising an effective resolution plan. Further, the SEBI Circular only prescribes the voting requirements for entering into the ICA. The voting thresholds for approval of a resolution plan by the debenture holders will be as per the ICA. It is expected that as more resolutions plans are considered by debenture holders, SEBI may also consider whether ISIN level voting provides the best outcome for debentures holders and make changes, if necessary.

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