By Prof. C. Scott Pryor

Good News for Secureds in India

Supreme Court Confirms Priority of Secured Claims (and More)

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In the September 2019 issue of the *ABI Journal*, we observed that the position of secured lenders under the new Indian Insolvency and Bankruptcy Code (IBC) was insecure.[1] Two months earlier, the National Company Law Appellate Panel (NCLAT) had held in *Essar Steel* that "there is no distinction made between one or other 'Financial Creditor.' … [A]ll of such persons form one class, *i.e.*, 'Financial Creditor' and they cannot be sub-classified as 'Secured' or 'Unsecured Financial Creditor.'").[2] The decision of the appellate panel eliminated any distinction between unsecured and secured creditors in an Indian reorganization case (a CIRP). On the other hand, the rights of secured creditors in their collateral would be unaffected in liquidation.

The *Essar Steel* case had been pending for more than a year when its committee of creditors (CoC) finally approved the resolution plan of ArcelorMittal India. The resolution plan proposed to pay secured financial creditors 92 percent of their claims and unsecured creditors either 100 percent (if their admitted claim was no more than 1 crore rupees[3]) or nothing at all (if the claim was for more than 1 crore). The wide disparity between the secured creditors and the bulk of the unsecured creditors was justified because the liquidation analysis showed that unsecured creditors would receive nothing in a liquidation. The appellate panel was unpersuaded and held that it was share and share alike in a CIRP.

The Government of India responded quickly with a set of amendments to the IBC designed to reestablish the priority of secured claims in a CIRP (the "2019 Amendments"). The 2019 Amendments firmly tethered the criteria for confirmation of section 30 of the IBC (similar to § 1129) to the priorities in a liquidation under section 53 of the IBC (similar to § 726).

Good News for Secured Creditors

Even before the enactment of the 2019 Amendments, the CoC in *Essar Steel* appealed to the Supreme Court to reverse the appellate panel's decision and reinstate the resolution plan that it had approved. Notwithstanding the 2019 Amendments, it was not a foregone conclusion that the Supreme Court would sustain the appeal. The members of the Indian judiciary are neither textualists nor originalists, and regularly show less deference to the text of legislation than is customary in the U.S.

On Nov. 15, the Supreme Court issued a 164-page opinion.[4] It summarily reversed the appellate panel and firmly ensconced the priority of secured creditors in their collateral. Working from the text of the 2019 Amendments and synthesizing a range of international materials, the Court concluded:

> [I]t can be seen that the Code and the Regulations, read as a whole, together with the observations of expert bodies and this Court's judgment, all lead to the conclusion that the equality principle cannot be stretched to treating unequals equally, as that will destroy the very objective of the Code.... Equitable treatment is to be accorded to each creditor depending upon the class to which it belongs: secured or unsecured, financial or operational.[5]

Better News

The Court did even more than restore the rights of secured creditors. It went out of its way to enhance the discretion of the CoC. As discussed in the previous *ABI Journal* article,[6] the IBC allocates to the CoC control of the resolution process and the power to choose among competing resolution plans. Moreover, the CoC is comprised only of financial creditors, almost all of which will be secured. In other words, secured creditors openly control a CIRP. With respect to their discretion, the Court wrote:

> The other argument based upon serious conflict of interest between secured and unsecured financial creditors ... is an argument which flies in the face of the majority of financial creditors being given complete discretion over feasibility and viability of

1 Prof. Scott Pryor, "Re-Secure in India: Government Acts Quickly to Restore Priority of Secured Claims," XXXVIII *ABI Journal* 9, 24-25, 65-66, September 2019, *available at* abi.org/abi-journal (unless otherwise specified, all links in this article were last visited on Jan. 22, 2020). The article also provides a primer on the history and structure of the IBC as a whole with special attention to the Corporate Insolvency Resolution Process (CIRP).

2 *Standard Chartered Bank v. Satish Kumar Gupta, Resolution Prof'l (In re Essar Steel Ltd.)* (NCLAT July 2019) ¶ 164.

3 Rs 1,00,00,000 (1 crore) ≈ $141,000.

4 *Comm. of Creditors of Essar Steel India Ltd. v. Satish Kuman Gupta* (Supreme Court 2019), *available at* main.sci.gov.in/supremecourt/2019/24417/24417_2019_4_1501_18158_Judgement_15-Nov-2019.pdf.

5 *Id.* at ¶ 57.

6 Pryor, *supra* n.1.

resolution plans, which includes the manner of distribution of debts [sic] that is contained in them.... *The Committee of Creditors does not act in any fiduciary capacity to any group of creditors.*[7]

Potentially Even Better News

The opinion of the Supreme Court in *Essar Steel* did not address an issue lurking in one of the official explanations to the 2019 Amendments. (Unlike statutes in the U.S., in India such explanations are part of the law.) Explanation 1 provides that regardless of the value of the assets that are subject to security interests, a distribution under a resolution plan that accords with the liquidation priorities shall be deemed "fair and equitable."[8]

This provision brings to mind cramdown under § 1129(b). However, when it comes to cramming down a secured creditor under chapter 11, "fair and equitable" requires that a secured creditor receive only the *value* of its collateral.[9] Following the 2019 Amendments, the cross-reference in section 30 of the IBC to the liquidation waterfall of section 53 mandates far more.

The liquidation priorities under section 53(1) of the IBC are not as neatly hierarchical as § 726 (or § 510). As one would expect, the IBC begins with the costs of administration,[10] then it proceeds to a joint priority of "*debts* owed to a secured creditor," which relinquishes its collateral in the liquidation proceeding, and unpaid workmen's dues (wages) accruing in the past 24 months.[11] Amounts due for the past 12 months to employees other than workmen[12] enjoy a third-level priority,[13] and in turn, they are followed by financial debts[14] owed to unsecured creditors.[15] The fifth priority is also joint: It includes taxes plus "debts owed to a secured creditor for any amount unpaid following the enforcement of [a] security interest."[16] Finally, and only at the sixth level of priority, are claims of unsecured creditors.[17]

There is no parallel to § 506(a) under the IBC; there is no bifurcation of claims of secured creditors. In other words, in a liquidation all financial debts — secured and unsecured (including deficiencies) — are to be paid before unsecured creditors. With the 2019 Amendments, the same should be true in reorganizations under the CIRP. Cramdown indeed!

Concluding Observations

In the U.S. over the past several decades, the power of secured creditors has changed the way in which chapter 11 is applied.[18] In India, just as much of the nation passed over landlines and moved directly to mobile telephony, the IBC has skipped chapter 11's highly structured and finely balanced "dance" among the debtor, its secured creditors and its unsecured creditors. Instead, the bulk of authority for a CIRP is placed squarely in the hands of a CoC made up of secured creditors, who owe no duty to unsecured creditors, and who have priority for payment of their full claims.

Most resolution plans will nonetheless allocate a portion of the value of the enterprise to unsecured creditors, even if that leaves secured creditors with a shortfall. Stiffing all operational creditors could make long-term rehabilitation of a firm very difficult. Still, where secured creditors are not paid in full, it is certainly possible that the CoC will approve a plan under which unsecured creditors receive nothing.

Whether the Indian Supreme Court will follow the text of the 2019 Amendments if faced with such a result remains to be seen. What is clear is that in the span of five months, the place of secured credit in India has seen an enormous reversal of fortune. abi

7 *Comm. of Creditors of Essar Steel India Ltd. v. Satish Kuman Gupta*, *supra* n.4 at ¶ 93 (emphasis added).
8 *See* Insolvency and Bankruptcy Code, No. 31 of 2016, § 30, India Code (2016), as amended, *available at* indiacode.nic.in: "Explanation 1. — For the removal of doubts, it is hereby clarified that a distribution in accordance with the provisions of this clause shall be fair and equitable to such creditors."
9 Section 1129(b)(2)(A).
10 I.B.C. s. 53(1)(a).
11 I.B.C. s. 53(1)(b) (emphasis added).
12 The distinction between "workmen" and "employees" is found in the India Disputes Act, 1947. In brief, employees are managers or supervisors of workmen.
13 I.B.C. s. 53(1)(c).
14 Recall that "financial debts" are typically owed to banks and other commercial lenders, as well as equipment lessors.
15 I.B.C. s. 53(1)(d).
16 I.B.C. s. 53(1)(e). The fifth-level priority for deficiency claims is for secured creditors who chose to "realize" their security interests outside the liquidation proceeding. Deficiencies of secured creditors who "relinquish" their security to the liquidation process enjoy the second-level priority of I.B.C. s. 53(1)(b). For a secured creditor in a liquidation, nothing like relief from the automatic stay is necessary. It can pull out its collateral upon request, subject to "proving" its security interest. I.B.C. s. 52(3). On the other hand, a secured creditor cannot "realize" its collateral in a CIRP; it is in for the long haul.
17 I.B.C. s. 53(1)(f).
18 *See* David A. Skeel & George Triantis, "Bankruptcy's Uneasy Shift to a Contract Paradigm," 166 *U. Penn. L. Rev.* 1777, 1779 (2018) ("The most dramatic development in [recent] decades ... has been the increasing use of actual contracts to shape the bankruptcy process.").