

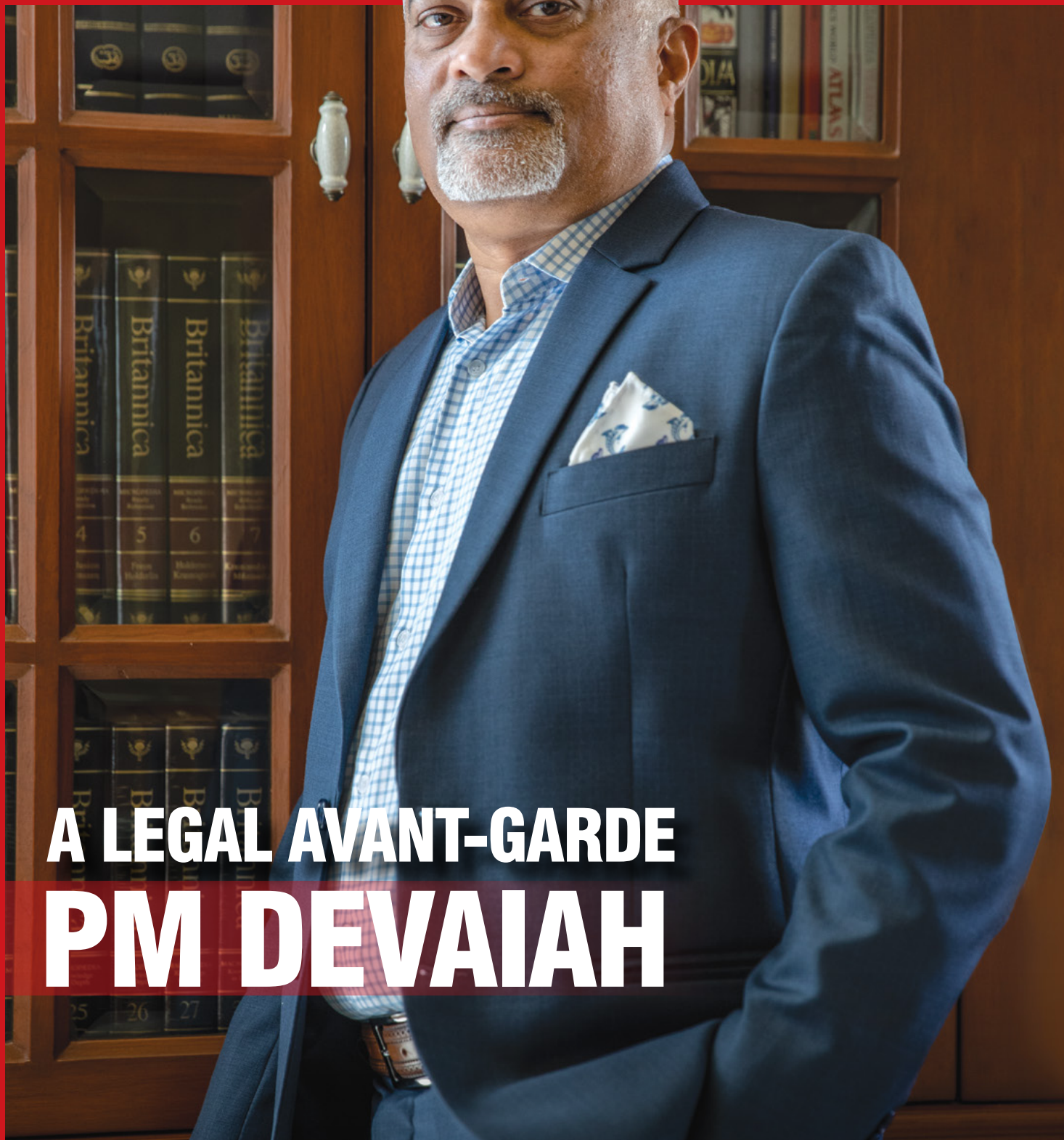
INDIA'S FIRST MAGAZINE ON LEGAL AND CORPORATE AFFAIRS

L E X

WITNESS

Volume 13 Issue 1 | Feb-Mar 2023

₹ 100 US \$10 UK £6



**A LEGAL AVANT-GARDE
PM DEVAIAH**

The Dilemma Surrounding Payment of Statutory Dues under Resolution Plans

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Statutory Dues under the provisions of the Insolvency and Bankruptcy Code, 2016 (IBC) are indeed Operational Debts and as Operational Creditors the Statutory Authority are in effect kept out of the decision making process in the insolvency resolution process. The resolution process under IBC culminates in either approval of a Resolution Plan or Liquidation. Approval of Resolution Plans have been subject to various forms of litigations since the IBC came into force. Over the years various legal issues have been set at rest by the Hon'ble Supreme Court recognizing the clear rights of various stakeholders including the Operational Creditors along with the scope of objections which could be even looked into by the Ld. National Company Law Tribunal (NCLT) while discharging functions as the Adjudicating Authority under IBC in case of approval of Resolution Plans.

Secured Creditors as a class have been all along protected under various legal regimes to the extent of their security interest even in cases of restructuring and/or liquidation. The term "secured creditor" essentially means a creditor

in whose favour some sort of security interest exists. The said term of "secured creditor" has been defined under various statutes such as the IBC and the SARFEASI Act. Additionally, in case of statutory dues, there is a concept of creation of statutory charge or lien which is also considered as a security interest in terms of specific statutory enactments. It is in terms of such statutory charges/interest that the demands of Statutory Authorities gain significance in resolution process under IBC.

The entire object and purpose of creation of a security interest is to protect the creditor in case of default by the Borrower to the extent of at least the value of the "security interest". However, the provisions of the IBC at the stage of resolution interestingly fails to statutorily recognize the specific rights of "secured creditors" to the extent of value of their security interest and proceeds with resolution while classifying creditors as "financial creditors", "operational creditors" and "other creditors". The recognition of rights of "secured creditors" thereafter, finds a preference in the liquidation proceedings under IBC wherein "secured creditors" are placed at the top of waterfall mechanism with a right to also stand out of the liquidation proceedings



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and realize their security interest outside the provisions of IBC.

During the stage of resolution, a resolution plan can be duly approved by the Committee of Creditors (CoC) so long as all the secured creditors are treated equally and a single secured creditor cannot insist upon payment of the entire amount of its security interest in a resolution plan (Reference to the judgment passed by the Hon'ble Supreme Court in the matter of Amit Mettaliks). Thus, a member of the CoC can fail to realise the entire value of its exclusive security interest in case of approval of a resolution plan by the requisite majority subject to provisions of Section 30(2)(b) of IBC.

The unique status of the secured creditors under IBC proceedings was all along interpreted as regards creditors in whose favour security interest was specifically created in terms of agreement/arrangement and thus ordinarily consisted of financial creditors. However, the said general understanding as regards categorization of creditors as "secured creditors" for IBC resolution process has in effect been interdicted in light of the judgment passed by the Hon'ble Supreme Court in the matter of State Tax Officer (1) vs Rainbow Papers Limited, 2022 SCC Online SC 1162. The Statutory Authorities are now to some extent brought within the ambit of the term "secured creditor" in light of the judgment passed by the Hon'ble Supreme Court in the matter of Rainbow Paper (Supra). The Hon'ble Supreme Court in the said matter while dealing with a claim under the Gujarat Value Added Tax, 2003 proceeded with recognizing the State as a secured creditor having security interest by creation of law and setting aside a



resolution plan which fails to pay the dues of statutory creditors viz. Gujarat Vat Department in the said matter.

To dilute the impact of the above mentioned judgment, the Ministry of Corporate Affairs has subsequently proposed amendments in the IBC on January 18, 2023. The proposed amendments inter alia also considers amending the definition of the term 'security interest' as provided under Section 3(30) of the IBC to clarify that the Debts owed to Central and State Governments are unsecured and the said statutory dues are to be treated as other unsecured creditors apart from circumstances where security interest is created through transaction/s i.e., arrangements or agreements.


The position of law as it exists today on a case to case basis warrants consideration of certain claims of statutory authorities as claims of secured creditors in a Resolution Plan. It is noteworthy that while placing reliance on the judgment passed by the Hon'ble Supreme Court in the matter of Rainbow Paper (Supra), the Ld. NCLT, Mumbai Bench in the matter of Lavasa Corporation Limited, has directed the CoC to revise the approved resolution plan to ensure that Government and Statutory Dues are treated similarly as other secured financial creditor. The said observation and direction of the Ld. NCLT incase replicated in other matters shall cause grave prejudice to the approval of pending resolution plans since the direction as passed by the Ld. NCLT is a sweeping direction which even fails to



record and deal with specific instances of security being created in favour of each Statutory Authority in accordance with the applicable provisions of law.

The status and position of statutory debts in the current scenario thus, clearly requires appropriate alignment to ensure that the object and purpose of IBC is met. IBC as an Act seeks to facilitate resolution process in case of companies undergoing financial stress. In the process of resolution, undoubtedly the creditors, specifically the financial creditors, have been placed in the driver's seat to steer the company towards a successful rehabilitation. Such successful rehabilitation cannot be premised on equal and identical treatment being accorded to secured financial creditor and statutory creditors since the financial creditors in terms of IBC are creditors who have directly

disbursed amount towards the working of the Company as against Statutory Creditors who are recipients of amounts on account of going concern status of the Company. Since both the categories of creditors are not similarly placed, the issue of equitable treatment to distinct category of creditors is clearly not in consonance with the provisions of IBC.

IBC has been repeatedly recognized as a complete Code which is driven towards continued operations and resolution of a Company and the provisions of the same are recognized to have an overriding effect. In the said background, the payment obligations under an approved Resolution Plan towards Statutory Creditors who are admittedly operational creditors, while being fair and equitable, ought not be identical with secured financial creditors in all matters. 



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