

# EARCL's security interest extinguished in Resolution Plan after notional value of One Rupee ascribed to claim – NCLAT upholds RP decision

The NCLAT in its recent judgment in **Edelweiss Asset Reconstruction Company Ltd. v. Mr. Anuj Jain, Resolution Professional of Ballarpur Industries Limited & Ors.** has held that when any asset, including security interest in an asset is part of the CIRP, a resolution plan can provide for extinguishment of such asset/ security interest in the resolution plan.

## Brief Facts:

- Yes Bank granted term loans to BILT Graphic Papers Products Limited (“BGPPL”). For the facility extended to BGPPL, Ballarpur Industries Limited (“Corporate Debtor”) created a mortgage with exclusive charge in favour of the security trustee on a certain land parcel in Orissa (“Land”). The Corporate Debtor also executed a corporate guarantee in favor of the security trustee.
- Subsequently, Yes Bank assigned its debt and underlying securities to Edelweiss Asset Reconstruction Company Ltd (“EARCL”). On an application under Section 7 of IBC by Finquest Financial Solutions Private Limited (“Finquest”), CIRP was initiated against the Corporate Debtor.
- EARCL’s claim as a secured financial creditor, which was rejected by the RP on the basis that there was no default by the principal borrower. EARCL’s claim was placed in the category of ‘other creditors’ as EARCL was a secured creditor at a notional value of Re. 1. EARCL neither challenged the rejection of claim nor the notional value of Re. 1 ascribed to its claim.
- In the CIRP, the resolution plan submitted by Finquest was declared as the winning bid. The plan provided for sale of the Land, proceeds of which were to be distributed among the financial creditors.
- EARCL sought reliefs before the NCLT seeking rejection of the resolution plan. The NCLT rejected EARCL’s prayer and approved the resolution plan. Aggrieved, EARCL filed an appeal before the NCLAT.

## What happened in the NCLAT

- EARCL relied on the judgment of the Supreme Court in Jaypee Kensington Boulevard Apartments Welfare Association and Ors. vs. NBCC (India) Ltd. & Ors. where the Supreme Court held that the security interest held by a third-party creditor cannot be set aside through the ipse dixit (authority/statement) of a Resolution Applicant.
- Jaypee Kensington is distinguishable. In Jaypee Kensington, the asset over which security had been created was not included as a part of the resolution process, whereas in the present case, the Land over which EARCL had security was part of the resolution process. Therefore, the Land could be dealt with under the resolution plan and could be liquidated for distribution among financial creditors.
- Where there is no default by the principal borrower, no actual loss suffered by the creditor. Where security interest has been extinguished by the resolution plan, it was always open for the creditor to ask the principal borrower for additional security.
- Here as EARCL had filed a claim, both EARCL and the Land were part of the CIRP. NCLAT rejected EARCL's appeal holding that extinguishment of the security interest of a third-party creditor was allowed in the course of a resolution process, where the security interest was a part of the CIRP.

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## Net effect of the NCLAT decision:

The NCLAT judgment gives rise to certain anomalies:

- If a creditor with security interest created over an asset of the Corporate Debtor does not file a claim in the CIRP, the asset will not be a part of CIRP. Consequently, a resolution plan cannot provide for treatment of such asset.
- Assets of the corporate debtor that will be part of the CIRP will be determined not on the basis of ownership by the corporate debtor, but whether a creditor having security interest over the asset has filed a claim.
- A secured creditor is better off without filing a claim as there is a risk that their security interest will be relinquished. By not filing a claim, the asset stays outside the CIRP and the creditor can realize the security interest outside the CIRP.
- Treatment of an asset is uncertain where multiple encumbrances are created on the same asset in favour of several creditors and all the creditors do not file claims in the CIRP.

EARCL has challenged the NCLAT judgment before the Supreme Court. Though the matter is yet to be heard, it can be expected that the Apex Court will intervene and clarify the position in due course.