



No action under Section 7 of IBC, where Creditor holds absolute right over the security interest and has agreed to a specific recourse for its enforcement: NCLT Mumbai

Recently, the National Company Law Tribunal, Mumbai (“**NCLT**”) vide its order dated 07.10.2021, held that no action under Section 7 of the Insolvency and Bankruptcy Code, 2016 (“**IBC**”) can be initiated due to non-payment of dues arising under a Debenture Trust Deed cum Indenture of Mortgage (“**DTD**”) if the financial creditor holds absolute right over the mortgaged property as its security interest and has agreed to a specific recourse for recovery of dues by way of enforcement of security created under the DTD.

In the present case, certain debentures were issued by Neptune Ventures and Developers Private Limited (“**Respondent/Corporate Debtor**”) under a registered DTD whereas Beacon Trusteeship Limited (“**Petitioner/Financial Creditor/Debenture Trustee**”) was appointed as the Debenture Trustee for the benefit of the Debenture Holder. These debentures were secured by way of registered mortgage of certain commercial premises in favor of the Debenture Trustee along with the receivables from the aforesaid premises were hypothecated and the personal guarantee of two promoters were given as security interest. In the event of non-payment of dues leading to occurrence of default, the DTD empowered the Petitioner to enforce the said security interest by various modes of enforcement. Subsequently, as the Respondent defaulted in repayment of dues under the DTD, the Petitioner filed an application under Section 7 of the IBC for initiation of Corporate Insolvency Resolution Process (“**CIRP**”).

Contesting the said application, the Respondent contended that since the DTD already provides a specific recourse addressing the consequence of non-payment of dues whereby the Petitioner may enforce the security interest created in its favour, therefore, no action under the provisions of IBC can be initiated by the Petitioner without exhausting the aforesaid remedy. It was further contended that an action under the IBC can be initiated only if, after enforcement of the said security interest in the manner as provided under the DTD, any amount remains due to the Petitioner.

The NCLT observed that as per the DTD executed between the parties, the debentures were secured by way of English mortgage under which all rights in the mortgaged property, including title, ownership and possession were absolutely transferred to the Petitioner. Further, the terms and conditions of the DTD disclosed that the Petitioner was empowered to recover dues through different modes of enforcement including sale of mortgaged properties. Considering the aforesaid observations, the NCLT held that no default had occurred and that since the Petitioner agreed to a specific recourse in the DTD for non-payment of dues by way of enforcement of security, it cannot be allowed to initiate an action under the provisions of IBC.

In our opinion, the aforesaid order of the NCLT has certain loopholes which are discussed hereinafter. *Firstly*, under the mandate of Section 7 of the IBC and as observed by the Supreme Court in *Innoventive Industries Ltd vs ICICI Bank*¹, the scope of inquiry while admitting an application for CIRP is limited to the extent of three conditions being satisfied viz., (i) existence of a financial debt, (ii) occurrence of default on the part of the debtor, and (iii) application filed under Section 7(2) of IBC being complete. In the present case, the NCLT did not undertake the above-mentioned inquiry and instead chose to interpret the terms of the agreement entered between the parties, which falls outside the purview of its jurisdiction. Interestingly, though the NCLT observed that the default had *not* occurred; yet, the Petitioner was held to have a specific recourse of enforcing its security in the manner as provided in the DTD. Here, having identified that no default had occurred, the accrual of remedy for enforcement of security, as observed by the NCLT, should also not have arisen at all. Moreover, as a consequence of holding that no default occurred upon non-payment of dues, the personal guarantee given by the promoters is also rendered redundant as the same could not be invoked by the Petitioner in absence of such default on the part of the Respondent. Thus, the NCLT not only overreached its jurisdiction by interpreting the terms of the agreement entered between the parties, but it also failed to duly appreciate the application to initiate CIRP based on the statutory conditions laid down under Section 7 of IBC and as upheld by the Supreme Court in *Innoventive Industries Ltd* (supra).

Secondly, as per Section 3(12) of IBC, 'default' occurs when a debt (in whole or in part or in instalment) has become due and payable but the same remains unpaid by the debtor. In the present case, the debt arising under the DTD stood due and payable and remained unpaid by the Respondent. Thus, the NCLT, erred in holding that no default had occurred even though it satisfied the threshold of definition of 'default' within the provisions of IBC.

Thirdly, as per clause 17.2.2 under the DTD, the Petitioner, in case of non-payment of dues leading to occurrence of default, was entitled to certain remedies agreed between the parties, '*without prejudice to any other rights it may have under the applicable law*'. The NCLT, however, overlooked the aforesaid clause as per which the Petitioner was entitled to take recourse to the appropriate remedy under the provisions of IBC, available in accordance with the applicable law.

Lastly, the NCLT observed that since the Petitioner had absolute right in the mortgaged properties by virtue of English mortgage, it had the recourse to sell the properties and recover the dues and thus could not initiate proceedings under the IBC. The NCLT however failed to interpret the mandate of English Mortgage under the Transfer of Property Act, 1882 ("**Act of 1882**"). Under the English mortgage, even though the term used is "absolute" transfer of interest, the same is qualified by re-transfer or reconveyance to the mortgagor upon payment of mortgage-money. Moreover, the mortgagor also retains its legal right of redemption under Section 60 of Act of 1882. Thus, the right of mortgagee under English mortgage is absolute only in form and not in substance.²

Accordingly, the law as laid down by the NCLT by way of the instant order seems to be flawed and requires reconsideration. The fact that there was an absolute title in favour of the Petitioner by virtue of English Mortgage, under which it was entitled to enforce its security interest as per the DTD and the applicable law, the same should not debar the unqualified right of the Petitioner to take recourse to any other remedy available, such as, moving an application under the IBC.

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¹ AIR 2017 SC 4084

² Ramkinkar v. Satyacharan, AIR 1939 PC 114