

Volume 04, Number 05 (February 05, 2021)

Phoenix Arc Private Limited Vs. Spade Financial Services Limited & Ors, Civil Appeal No. 2842 of 2020 with Civil Appeal No. 3063 of 2020, Supreme Court of India Date of order: 01 February 2021

If the borrower is not obligated to return the money or its equivalent along with the consideration for a time value of the money to the creditor, such a debt will be considered 'collusive in nature' and the creditor cannot be granted the status of a Financial Creditor under IBC, 2016.

Facts of the case: -

Though the judgement has a wider perspective, it is crucial for Group Insolvency. The Adjudicating Authority in a judgement on July 19, 2019 held that AAA and Spade have to be excluded from the CoC formed in relation to the CIRP initiated against AKME Projects Limited as they were related to the Debtor. The appeal against the NCLT order was dismissed by NCLAT on January 27, 2020. In the Supreme Court, the Appellant (Phoenix) argued that though the NCLAT correctly dismissed the appeal filed by Spade and AAA, holding that they are related parties of the Corporate Debtor and are hence to be excluded from the CoC, there is an erroneous finding that they are financial creditors.

Supreme Court Judgement: -

A Supreme Court bench comprising Justice D. Y. Chandrachud, Justice Indu Malhotra and Justice Indira Banerjee delivered its judgement on February 01, 2021 in which the bench adjudicated on several legal questions pertaining to group insolvency. The judgement could be summarized as follows:

Financial Debt: Citing various previous judgements, the SC held that the borrower is obligated to return the money or its equivalent along with the consideration for a time value of money, which is the compensation or price payable for the period for which the money is lent. Due to the collusive nature of their transactions alleged to be a financial debt under Section 5(8), Spade and AAA cannot be labelled as financial creditors under Section 5(7).





Indian Institute of Insolvency Professionals of ICAI

(Company formed by ICAI as per Section 8 of the Companies Act 2013)

Related Party under Section 5(24) and 5(29) of the IBC: The objects and purposes of the Code are best served when CIRP is driven by external creditors, so as to ensure that the CoC is not sabotaged by related parties of the Corporate Debtor.

This is the intent behind the first proviso to Section 21(2) which disqualifies a financial creditor or the authorized representative of the financial creditor under sub-section (6) or sub-section (6A) or sub-section (5) of section 24, if it is a related party of the corporate debtor, from having any right of representation, participation or voting in a meeting of the committee of creditors. The decision of the NCLAT, in as much as it excluded Spade and AAA from the CoC in accordance with the first proviso of Section 21(2), is affirmed with reasons.

Meaning of simple present tense in the 1st proviso to Sec. 21(2): -

It was argued before this Court that a literal interpretation should be given to Section 19(1). Since the word “is” has been used in sub-sections (a), (b) and (c), it was urged that this would exclude a public servant who had abused office at an earlier point in time and has now ceased to occupy that office.

After analyzing several precedents in this regard such as *R S Nayak v. A R Antulay* and *Arcelor Mittal India Private Limited v. Satish Kumar Gupta* the bench observed “it is thus clear on a reading of English, US, Australian and our own Supreme Court judgments that the “Lakshman Rekha” has in fact been extended to move away from the strictly literal Rule of interpretation back to the Rule of the old English case of Heydon [Heydon case, (1584) 3 Co Rep 7a: 76 ER 637], where the Court must have recourse to the purpose, object, text and context of a particular provision before arriving at a judicial result.

The appeal is disposed of.

