China Development Bank v. Doha Bank QPSC and Ors – The Supreme Court clarifies the term 'Financial Creditor' under the IBC

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China Development Bank v. Doha Bank Q.P.S.C – The Supreme Court clarifies the scope of the term 'Financial Creditor' under the IBC

Executive Summary

1. Some important takeaways from this decision of the Supreme Court of India, are that:

   (a) When a financial instrument creates a liability in the nature of a claim under Section 3(6) of the Insolvency and Bankruptcy Code, 2016 ("IBC"), the moratorium under Section 14 of the IBC prevents actions for recovery but does not denude the debtor of its liability under the instrument.

   (b) There is no requirement of a default having occurred when a claim is submitted to a Resolution Professional by a Financial Creditor in respect of a Financial Debt. Default is a requirement only when a Financial Creditor is presenting an application under Section 7 of the IBC.

   (c) The question of whether the cause of action for invoking a guarantee has arisen or not is not relevant to determine whether a claim exists.

2. What follows from the Supreme Court of India's decision is that a Financial Creditor may participate in the Committee of Creditors of a Corporate Guarantor if they have a claim under a valid contract of guarantee. This gives the Financial Creditor vital control over important parts of the corporate insolvency resolution process such as the approval of Resolution Plans.

Introduction

3. The Supreme Court of India in its decision dated 20 December 2024, in *China Development Bank v. Doha Bank QPSC & Ors*[1] (**"China Development Bank"**) intervened in a conflict between members of a Committee of Creditors ("**CoC**") in an ongoing Corporate Insolvency Resolution Process (CIRP) by providing clarity on the term 'Financial Creditor' under the IBC.

4. The fundamental question before the Court was determining the status of the Appellants, including China Development Bank, as Financial Creditors, thereby

[1] China Development Bank v. Doha Bank QPSC & Ors | Civil Appeal No. 7298 of 2022, decision dated 20 December 2024

making them eligible to be members of the CoC, which status the Respondent had challenged along with subsequent resolutions of the CoC passed while the Appellants were members.

Factual Matrix

5. The Corporate Debtor, Reliance Infratel Limited ("**RITL**") along with group entities, Reliance Communications Infrastructure Ltd. ("**RCIL**"), Reliance Communications Ltd. ("**RCom**") and Reliance Telecom Ltd. ("**RTL**") had entered into Deeds of Hypothecation on various dates (collectively "**DoH**") which created charges over their combined assets and imposed a joint and several liability for the debts of any of the group entities.

6. The group entities entered into a Master Security Trustee Agreement (MSTA) where a Security Trustee was appointed which had executed the DoHs on behalf of the Appellants and had the right to enforce the security interests thereunder.

7. The DoHs were executed by the group entities jointly and the companies pooled their resources together and created a charge thereon in favour of the Appellant, China Development Bank. The group entities also each agreed to pay any shortfall of debts owed by any of them such that each entity would be individually liable to pay the debt of all of the other entities.

8. When the CIRP was initiated against the Corporate Debtor under the IBC, a Resolution Professional was appointed, who called for claims from the company's creditors. The Appellants submitted claims pursuant to a public announcement under Section 15 of the IBC on the basis that they were Financial Creditors of the Corporate Debtor.

9. The Resolution Professional accepted the Appellants' claim and classified the Appellants as Financial Creditors of the Corporate Debtor.

10. The Respondent, Doha Bank QPSC file an application before the NCLT to challenge the Appellants' admission to the COC on the basis that the Appellants were not Financial Creditors, not having directly lent to the Corporate Debtor. While the application was pending, a Resolution Plan came to be submitted to the COC and approved.

11. The Respondent appealed the NCLT's decision to approve the Resolution Plan without hearing its objection as to the status of the Appellant. The NCLAT remanded the matter to the NCLT with a direction to hear the Respondent's application and held that the approval of the Resolution Plan would be made contingent on the outcome of the Respondent's application.

12. The NCLT dismissed the Respondent's application after hearing and upheld the Appellants' status as Financial Creditors.

13. The NCLT's order was set aside in an appeal before the NCLAT filed by the Respondent. The NCLAT remanded the matter to the NCLT for orders consequent to its de-recognising the Appellants as Financial Creditors.

14. The NCLAT's judgement came to be appealed before the Supreme Court of India, under Section 62 of the IBC.

Analysis

15. The basis of the NCLAT's decision that was appealed before the Supreme Court in the *China Development Bank* case was that the DoH which created a charge on the assets of the group companies was not a contract of guarantee and therefore could not be regarded as a contract that created a financial debt in terms of Section 5 (i) of the IBC.

16. The Appellants argued before the Supreme Court of India that in terms of the DoHs it had executed, the Corporate Debtor along with the other companies in the Reliance Communications group had agreed to assume liability on an individual level for the debts of each of the other entities, which obligation is in the nature of a guarantee.

17. It also argues that the Corporate Debtor executed the DoHs in the capacity of a Chargor and Obligor. Further, that the Corporate Debtor created a first ranking *pari passu* charge on its assets in favour of the Security Trustee which acted on behalf of the Appellants.

18. The Respondent argued that the Appellants were not entitled to file a claim under Form-C of the IBC pursuant to a public announcement because there was no default or shortfall when the claim was filed.

19. The Respondent contended that the Appellants were secured creditors at best whose rights to recover against collateralized assets ceased when a moratorium was imposed under Section 14 of the IBC.

20. The Appellants in rejoinder attempted to distinguish between a claim filed before a Resolution Professional after a public announcement under Section 15 of the IBC and the requirement of a default to file an application to initiate CIRP under Section 7 of the IBC. The Appellants also contended that the moratorium only barred actions for recovery and not claims before the Resolution Professional.

21. The Respondent then argued that the DoH did not fulfil the requirement of a contract of guarantee under Section 126 of the Indian Contract Act, as it did record the presence of a Guarantor, Principal Debtor and Creditor.

22. According to the Respondent the obligation in the DoH was to satisfy a shortfall that arose upon the sale of the hypothecated assets. Since the moratorium under Section 14 of the IBC prevented the sale of these and other secured assets, the contingent event that would make the Appellants Financial Creditors, had not occurred.

23. The Supreme Court of India held that the determination of whether the Appellants before it were considered Financial Creditors, depended on whether the Appellants were guarantors. It observed that it was an admitted position that other group entities excluding the Corporate Debtor had borrowed money from the Appellants against payment if interest under facility agreements.

24. It held that –

> *"… A contract becomes a guarantee when the contract is to perform the promise or discharge the liability of a third person in case of default. Thus, when a person enters into a contract to perform or discharge the liability of a third party, the contract becomes a contract of guarantee.*
>
> *51. Section 127 of the Contract Act reads thus: "127. Consideration for guarantee.- Anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.*

Hence, any promise made or anything done for the benefit of principal debtor may be sufficient consideration to the surety for giving guarantee."[2]

25. The Supreme Court then went on to examine the DoH in its decision. In that context it recognised that it was a settled principle that the nomenclature of an instrument would not supplant its contents when a Court was determining the nature of the instrument.

26. The Supreme Court observed that the parties to the DoH were Security Trustees (Under the MSTA), the Corporate Debtor who is not the borrower, and the other group companies which were advanced debts by the Appellants.

27. The Court held that the DoH made it clear that the Corporate Debtor had undertaken to discharge the liability of its group companies who were the borrowers of the Appellants.

28. Pertinently the Supreme Court clarified in the context of a claim submitted under Form-C of the IBC pursuant to a public announcement calling for claims by the Resolution Professional under Section 15 of the IBC that –

"There is an argument canvassed before us that default under the DoH has not occurred. We have already quoted the definition of 'financial debt' under Section 5(8) of the IBC. There is n requirement incorporated therein that a debt becomes financial debt only when default occurs. Under Section 5(7) of the IBC, any person to whom financial debt is owed becomes a Financial Creditor even if there is no default in payment of debt. Therefore, this argument deserves to be rejected."

29. The Supreme Court of India went on to clarify that –

"On this aspect, we may also note that under Section 3(12), 'default' has been defined. This definition of 'default' becomes relevant only while invoking the provisions of Section 7(1) of the IBC when the CIRP is sought to be initiated by the Financial Creditor. Section 7(1) provides that a Financial Creditor can initiate CIRP against the Corporate Debtor. There is no requirement under Section 5(8) of the IBC that there can be a debt only when there is a default…"[3]

[2] [50] and [51] of China Development Bank v. Doha Bank QPSC & Ors | Civil Appeal No. 7298 of 2022, decision dated 20 December 2024
[3] [62] of China Development Bank v. Doha Bank QPSC & Ors | Civil Appeal No. 7298 of 2022, decision dated 20 December 2024

30. Addressing the Respondent's argument that since the contingent event under the DoH, the sale of hypothecated assets could not take place in light of the moratorium under Section 14, the Supreme Court held that the moratorium only prohibited actions for recovery. It observed that the liability under the instruments subsisted, and it was based on the liability that a claim was made to the Resolution Professional.

31. The Supreme Court also observed in the context of the definition of a 'claim' under Section 3(6) of the IBC that –

> *"If the right to payment exists or if a breach of contract gives rise to a right to payment, the definition of 'claim' is attracted. Even if that right cannot be enforced by reason of applicability of the moratorium the claim will still exist. Therefore, whether the cause of action for invoking the guarantee has arisen or not is not relevant for considering the definition of 'claim'."*[4]

32. Based on the above reasoning, the Supreme Court allowed the appeals and set aside the decision of the NCLAT impugned before it and restored the decision of the NCLT upholding the status of the Appellants as Financial Creditors.

[4] [65] of China Development Bank v. Doha Bank QPSC & Ors | Civil Appeal No. 7298 of 2022, decision dated 20 December 2024