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Distribution of Sale Proceeds between First and Second Charge Holders under Liquidation: An Unsettled but Evolving Legal Position

The Insolvency and Bankruptcy Code, 2016 aims to create a coherent and predictable insolvency framework grounded in value maximization and equitable stakeholder treatment. This article analyses the statutory scheme under Sections 52 and 53 of the Code, its interaction with pre-IBC principles under the Transfer of Property Act, 1882, and the divergent approaches adopted by the NCLT and NCLAT. It critically examines key decisions, including '*Technology Development Board v. Anil Goel and IDBI Bank Ltd. v. Deepika Bhugra Prasad*', which reconceptualise secured creditors as a single class upon relinquishment of security. The article concludes by highlighting the unsettled nature of the issue pending adjudication before the Hon'ble Supreme Court and its implications for liquidation outcomes and creditor strategy.



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INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 represents a decisive departure from the fragmented enforcement regime that prevailed prior to its enactment. The Code introduced a creditor-in-control model, time-bound insolvency processes, and a comprehensive statutory waterfall for distribution of proceeds during liquidation in accordance with the provisions of Section 53 of the Code. Notwithstanding its detailed framework, the Code has left certain foundational questions unresolved, necessitating judicial interpretation.

One such contentious issue concerns the distribution of sale proceeds between secured creditors holding first and second charges over the same asset. Under pre-IBC jurisprudence, priority between such creditors was governed by settled principles of property law, most notably Section 48 of the Transfer of Property Act, 1882. The first charge holder enjoyed unquestioned precedence over subsequent charge holders.

The IBC alters this landscape by introducing a statutory election under Section 52 and a class-based distribution mechanism under Section 53. Whether these provisions preserve traditional inter se priorities or replace them with pari passu treatment upon relinquishment of security has emerged as a critical question in liquidation jurisprudence.

THE CORE LEGAL ISSUE

The central question may be framed as:

In terms of Section 52 of the Code, read with Regulation 21A of the IBBI (Liquidation Process) Regulations, 2016 ("**Liquidation Regulations**"), where a Secured Creditor having a first charge over a particular asset opts to realize its security interest independently outside the liquidation estate, what shall be the treatment and entitlement of other Secured Creditors holding a second or subsequent charge over the same asset during the liquidation process?

Furthermore, the question arises whether in case where the Secured Creditor chose to relinquish the Security Interest and would not proceed for realization under Section 52 of the Code, in that case there remains no classification inter se, i.e. all the Secured Creditors rank equal (pari passu), irrespective of the fact that they have inter se priority in security charge.

PRE-IBC JURISPRUDENCE AND ITS LIMITS

Before the enactment of the IBC, courts consistently upheld the priority of first-charge holders. In *ICICI Bank Ltd. v. Sidco Leathers Ltd.*, the Supreme Court affirmed that a first charge holder must be paid in priority to a second charge holder, drawing support from Section 48 of the Transfer of Property Act, 1882 and the scheme of the Companies Act, 1956.

However, these decisions were rendered in a fundamentally different statutory context. The IBC, with its overriding clause under Section 238 and its emphasis on collective insolvency resolution, raises the question whether such precedents can continue to govern liquidation distribution under the new regime.

RELINQUISHMENT VS. REALISATION: A CRITICAL DISTINCTION

An important nuance emerges from the statutory framework and judicial reasoning:

- Where a secured creditor realises its security outside liquidation under Section 52, traditional charge



priority continues to operate. A first-charge holder is entitled to be paid in full before any residual value flows to a second-charge holder.

- Where a secured creditor relinquishes its security, it submits to the statutory waterfall under Section 53, where inter-se priority is not recognised.

This distinction preserves contractual rights at the enforcement stage while subordinating them to statutory distribution once security is surrendered to the liquidation estate.

PARA 21 OF THE REPORT OF INSOLVENCY LAW COMMITTEE DATED 26TH MARCH, 2018

The relevant extract from Paragraph 21 of the said judgment, wherein the conclusion on the subject has been drawn, is reproduced hereunder for ready reference:

“21.6 To conclude, the Committee was of the opinion that it is sufficiently clear from a plain reading of Section 53(1)(b) that it intended to rank workmen’s dues equally with debts owed to secured creditors who have relinquished their security. Section 53(1)(b) does not talk about priority inter se secured creditors. Thus, valid inter-creditor/subordination agreements would continue to govern their relationship. Further sub-section (2) of Section 53 must also be interpreted accordingly. For instance, applying Section 53(2) in the context of Section 53(1)(b), any agreements between workmen and secured creditors which disrupts their pari passu rights will be disregarded by the

liquidator. However, agreements inter-se secured creditors do not disturb the equal ranking sought to be provided by Section 53(1)(b) and therefore do not fall within the ambit of Section 53(2). The Committee felt that there was no requirement for an amendment to the Code required since a plain reading of Section 53 was sufficient to establish that valid inter-creditor and subordination provisions are required to be respected in the liquidation waterfall under Section 53 of the Code.”

In view of the above, it can be concluded that the inter se priorities amongst the secured creditors will remain valid and prevail in distribution of assets in liquidation.

TECHNOLOGY DEVELOPMENT BOARD VS. ANIL GOEL: REDEFINING SECURED CREDITORS AS A CLASS

The debate came to the fore in *Technology Development Board v. Anil Goel*, where the NCLAT was called upon to decide whether first-charge holders could appropriate the entire sale proceeds to the exclusion of a second-charge holder after relinquishment of security.

The NCLAT held that:

- Once secured creditors relinquish their security interest, they form a single class under Section 53(1)(b) (ii).
- Section 53 does not permit sub-classification among secured creditors based on charge ranking.

- Pre-IBC principles and Section 48 of the Transfer of Property Act cannot override the statutory waterfall due to Section 238 of the Code.

This ruling marked a significant doctrinal shift from asset-centric enforcement to class-centric distribution.

ANALYSIS

A. Priority to First Charge Holder under Inter Se Secured Creditors

The judgement passed by the Hon'ble NCLT, Kolkata Bench in the case of *Sree Metalika Limited vs. SREI Equipment Finance and Engineering Limited (Company Petition (IB) No.16/KB/2017)* and the judgement of Hon'ble Supreme Court in the case of *ICICI Bank Ltd vs. Sidco Leathers Ltd. & Ors in Appeal (civil) 2332 of 2006* provides for the distribution of Liquidation Sale Proceeds while considering the following aspects based on the interpretation of Section 53 and Para 21 of the Report of Insolvency Law Committee dated 26th March, 2018:

1. The CIRP Costs and Liquidation Costs shall be paid off in priority, thereafter;
2. The first charge holder of a particular asset will be entitled to receive sale proceeds in priority up to the payment of its debt in full, after which, the second charge holders would be paid from the balance sale proceeds, if any;
3. If a particular Secured Stakeholder has exclusive charge on any asset, it alone shall be entitled to receive the proceeds from sale of such asset;
4. Pari passu charge holders shall be paid in proportion of their debt;
5. In case, *SFC 1 and SFC 2 is having the First Charge and Second Charge respectively over the same Asset Block*, the SFC 1 will be entitled to receive sale proceeds in priority up to the payment of its debt in full, after which, the SFC 2 would be paid from the balance sale proceeds, if any.

In case, SFC 1 and SFC 2 having the *first charge – pari passu over same Asset Block*, the proceeds from the said asset shall be distributed between the secured creditors in proportion to their admitted claim amount.

Also, in case the Secured Creditor has *First Exclusive Charge* over Asset, the whole proceeds were required to be disbursed to such Secured Creditor only.

6. Upon allocation of the sale proceeds of the secured assets to the secured creditors holding security

interests therein, the residual outstanding debt shall be crystallized. Any further realizations from the sale or recovery of other assets shall thereafter be distributed *pro rata* among such creditors in proportion to their respective balance outstanding debts.

B. Non-Recognition of Inter Se Priority amongst Secured Creditors

Once Secured Creditors relinquish their security interests to the liquidation estate, the distinction between first and second charge becomes irrelevant. The relinquished assets form part of the common liquidation pool and their proceeds must be distributed strictly in accordance with Section 53 of the Code, which does not recognize any sub-classification among Secured Creditors. Where the Secured Creditors relinquished their security interest to the liquidation estate, the right on the assets shall be forfeited. The only right available to them was to receive proceeds from the sale of assets in the manner provided in Section 53.

The question of distribution between first-charge and second-charge holders under liquidation lies at the intersection of property law, contract law, and insolvency policy.

Accordingly, the first charge holder will have priority in realizing its security interest if it elects to realize its security interest and does not relinquish the same. However, once a Secured Creditor opts to relinquish its security interest, the distribution of assets would be governed by the provision engrafted in Section 53(1)(b) (ii) whereunder all Secured Creditors having relinquished security interest rank equally and in the waterfall mechanism, are second only to the insolvency resolution process costs and the liquidation costs.

DISTRIBUTION OF SALE PROCEEDS UPON SALE OF CORPORATE DEBTOR AS GOING CONCERN DURING LIQUIDATION

If the Corporate Debtor has been sold as Going Concern during the Liquidation, the Secured Creditors might have multiple charge (1st and 2nd Charge) over the particular block of assets, in that case how the distribution of asset will be made?

The judgment dated **20.12.2023** rendered by the Hon'ble National Company Law Tribunal (NCLT), Kolkata Bench, in *IDBI Bank vs. Mrs. Deepika Bhugra Prasad, Liquidator of ESS DEE Aluminium Limited under IA(IB) No. 1694/(KB)/2022 in CP(IB) No. 1284/(KB)/2019*. The crux for the analysis of the said judgement is as hereunder:

A judgment of Hon'ble NCLT in Comp App. (AT)(Ins.) No. 547 of 2022 in the matter of *Oriental Bank of Commerce vs. Anil Anchalia Liquidator of Bala Technologies & Ors*. In light of the above, it is expedient to examine the applicability of the above judgment in respect of M/s. Amit Metaliks referred to above on the facts of this case. Para 22 of the judgment is extracted below:

22. *It needs hardly any emphasis that if the propositions suggested on behalf of the appellant were to be accepted, the result would be that rather than insolvency resolution and maximisation of the value of assets of the corporate debtor, the processes would lead to more liquidations, with every secured financial creditor opting to stand on dissent. Such a result would be defeating the very purpose envisaged by the Code; and cannot be countenanced. We may profitably refer to the relevant observations in this regard by this Court in Essar Steel as follows:—*

“85. Indeed, if an “equality for all” approach recognising the rights of different classes of creditors as part of an insolvency resolution process is adopted, secured financial creditors will, in many cases, be incentivised to vote for liquidation rather than resolution, as they would have better rights if the corporate debtor was to be liquidated rather than a resolution plan being approved. This would defeat the entire objective of the Code which is to first ensure that resolution of distressed assets takes place and only if the same is not possible should liquidation follow.”

The ratio decendi of the above judgement is that all the similarly situated creditors shall be treated equally as a class and their treatment shall not be dependent on the value of securities held by the constituents of a class, which in this case are the Secured Creditors, who have relinquished their security interest. By this measure, all Secured Creditors who have relinquished their security interest shall be given an equitable treatment. The Section 53 of the Code, which deals with the distribution of assets and specifies the methodology of distribution of the proceeds of sale of liquidation of a Corporate Debtor and routinely referred to as the Waterfall mechanism.

From the emphasized text in 53(1)(b)(ii), we note that two words have been stressed-on in the statute are ‘between and among’. Thus, while the first word i.e. “between” is intended to integrate the two different classes i.e. the workmen and the Secured Creditor, which shall therefore rank equally, the other word i.e. “among” signifies the equality within a group which herein consists of all such secured creditors who have relinquished their security interest in line with Section 52.

Since there is no quarrel on the issue of relinquishment, therefore the significance of the word “among” relates to the inter se relationship between all such secured creditors and these have to be then given an equitable treatment which shall mean in proportion to their admitted claim.

Section 53 does not differentiate between the quantum or magnitude of the relinquishment, which is taken care while distributing the proceeds on a proportional basis.

ILLUSTRATIVE ANALYSIS

Where a Secured Financial Creditor (SFC 1) having first charge over a particular block of asset and they opt for not to relinquish their right over the security interest while the other Secured Creditor (SFC 2) who is also having the first charge pari-passu over the same block of asset and they opted to relinquish their right over the asset.

In light of the foregoing analysis, it can be concluded that the SFC 1 might proceed for selling the asset in accordance with the Section 52 of the Code read with Liquidation Regulations, and the sale proceeds received from such sale of assets shall

be distributed between the SFC 1 and SFC 2 (SFC 1 and SFC 2 having first charge pari passu over the same block of assets) in proportionate to their admitted claim amount.

However, if SFC 2 is having the Second Charge over the said particular block of asset, instead of first charge pari passu, then the SFC 1 might proceed for selling the asset in accordance with the Section 52 of the Code read with Liquidation Regulations, and the sale proceeds received from such sale of assets shall be first appropriated towards the dues of the SFC 1, thereafter, residual amount shall belong to the SFC 2.

SUPREME COURT INTERVENTION AND PENDING UNCERTAINTY

The judgments passed by the Hon'ble NCLAT in *Kotak Mahindra Bank Limited v. Technology Development Board (Civil Appeal No. 2359 of 2021)* and *IFCI Limited vs. (i) IDBI Bank Limited and (ii) Ms. Deepika Bhugra Prasad, Liquidator of Ess Dee Aluminium Limited (Civil Appeal No. 1424 of 2025)* have been assailed before the Hon'ble Supreme Court of India.

In *Kotak Mahindra Bank Limited vs. Technology Development Board, the Hon'ble Supreme Court*, vide its order dated 9th June 2021, granted a stay on the operation of the impugned judgment and order passed by the Hon'ble NCLAT on 5 April 2021. Subsequently, vide order dated 13th September 2024, the Insolvency and Bankruptcy Board of India (“IBBI”) was impleaded as a party-respondent at the instance of the Appellant.

Further, in *IFCI Limited vs. IDBI Bank Limited & Anr., the Hon'ble Supreme Court*, vide its order dated 14th February 2025, stayed the operation of the impugned judgment and order dated 28th January 2025 passed by the Hon'ble NCLAT in Company Appeal (AT) (Insolvency) No. 335 of 2024.

As on date, both matters remain pending for adjudication before the Hon'ble Supreme Court. The next date of hearing in these matters is presently not reflected on the Court's portal.

CONCLUSION

The question of distribution between first-charge and second-charge holders under liquidation lies at the intersection of property law, contract law, and insolvency policy. The IBC appears to draw a clear conceptual line: **priority survives enforcement but dissolves upon relinquishment.**

A definitive ruling by the Hon'ble Supreme Court is awaited to settle this issue conclusively. Such clarity will be crucial not only for liquidation practice but also for shaping creditor behaviour, inter-creditor arrangements, and lending strategies under India's insolvency framework.

REFERENCES:

- i. *ICICI Bank Ltd. v. Sidco Leathers Ltd., (2006) 10 SCC 452.*
- ii. *IDBI Bank Ltd. v. Deepika Bhugra Prasad, IA(IB) No. 1694/(KB)/2022 (NCLT Kolkata Bench).*
- iii. *Insolvency and Bankruptcy Code, 2016, Sec. 52, 53, 238.*
- iv. *Technology Development Board v. Anil Goel, Company Appeal (AT) (Insolvency) No. 731 of 2020 (NCLAT).*
- v. *Transfer of Property Act, 1882, Sec. 48.*

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