2025 INSC 1259

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 11077 OF 2025

EPC Constructions India
Limited Through Its
Liquidator - Abhijit Guhathakurta ...Appellant(s)

VERSUS

M/s Matix Fertilizers And
Chemicals Limited ...Respondent(s)

J U D G M E N T

K.V. Viswanathan, J.

1. The present appeal calls in question the correctness of the judgment and order dated 09.04.2025 passed by the National Company Law Appellate Tribunal (for short the 'NCLAT') in Company Appeal (AT) (Insolvency) No. 1424 of 2023. The NCLAT dismissed the appeal of the appellant and confirmed the order dated 29.08.2023 passed by the Adjudicating Authority-National Company Law Tribunal (for

short the 'NCLT'), Division Bench, Court No.II, Kolkata. The NCLAT had dismissed the application of the appellant filed under Section 7 of the Insolvency and Bankruptcy Code, 2016 (for short the 'IBC').

2. Both the NCLT and the NCLAT held that the Cumulative Redeemable Preference Shares (for short 'CRPS') held by the appellant is in the nature of an investment and not a debt. It further held that since payment against the CRPS is not due, no liability can be said to arise.

3. To appreciate the controversy in question, a brief reference to the facts of the case, needs to be made.

BRIEF FACTS :-

OFFER AND ACCEPTANCE OF CRPS:-

4. The appellant-EPC Constructions India Limited (for short 'EPCC') was formerly known as Essar Projects India Limited. It entered into an engineering and construction contract with the respondent-M/s Matix Fertilizers and Chemicals Limited (for short 'Matix') on 11.12.2009. The

contract was for the establishment of a fertilizer complex for Ammonia and Urea production at Panagarh Industrial Park, District Burdwan, West Bengal. The project involved designing, engineering, procurement, construction, erection and installation. An On-shore Supply Contract was executed on 29.07.2010 (for supply of Indian origin plant and equipment) and an Off-shore Supply Contract was entered on 20.08.2010 for supply of non-Indian origin plant and equipment.

5. According to the appellant, under the above mentioned contracts, a sum of INR 572.72 crores (Five Hundred Seventy-Two Crores and Seventy Two Lakhs only) became due and payable by Matix to the appellant. According to the appellant, correspondence was exchanged between the contracting parties to convert a portion of the receivables to a subordinate debt, the terms of which were to be discussed.

6. This resulted in a letter written by the respondent-Matix on 27.07.2015 whereby Matix requested EPCC to convert the outstanding amounts up to Rs. 400 crores into Non-

Cumulative Redeemable Preference Shares (NCRPS). By a letter of 30.07.2015, the board resolution passed by EPCC dated 30.07.2015 was communicated to the respondent. Under the board resolution, EPCC agreed to convert a portion of the receivables into CRPS. The relevant part of the resolution is extracted hereinbelow:-

> "6. INVESTMENT IN CUMULATIVE REDEEMABLE PREFERENCE SHARES OF MATIX FERTILIZER AND CHEMICALS LIMITED
>
> ..... Matix has informed the Company that due to shifting of SCOD, cost of completion for the Project has increased and it requires additional funding of Rs 1,210 Crores to complete the Project for which it has approached its lenders. However, due to this delay even further disbursement of existing credit facilities sanctioned has also been withheld by its lenders.
>
> She further added that vide this letter, Matix had given the Company a proposal for conversion of its dues of Rs. 400 Crores payable to the Company on account of the project work into Redeemable Preference Shares (RPS). It was informed by Matix that its lenders have extended additional credit facilities provided Matix bring additional equity to such extent to achieve the Debt Equity Ratio (DER) of 2:1 and therefore by conversion of dues of the Company into RPS will facilitate Matix to show equity infusion and it can draw additional credit facilities which will enable it to complete the Project.
>
> Further Mr. Sawa clarified to the Board that at present, Matix does not have enough liquidity to repay the outstanding dues of the Company and even complete the balance part of the project. Realizing this, lenders have also sanctioned additional debt to Matix to complete the

project. If Matix does not get additional funding from its lenders, the project will not be completed which will hamper the possibilities to recover Company's outstanding amount from Matix. Therefore it is in the best interest of the Company to extend support to Matix by making investment in the RPS that will help Matix drawdown additional debt for completion of the project and also commence its operations. This in turn will help Matix to raise fresh equity which will be used to redeem the RPS as assured by Matix vide their letter dated July 27, 2015.

The Directors then discussed about the terms and conditions of the proposal given by Matix. The Company Secretary explained in detail the terms and conditions of the RPS. She also informed the Board that if the proposal is accepted by the Board of Directors, there will be no outflow of funds from the Company and only the outstanding receivables will be converted into RPS.

The Directors after further deliberation desired that RPS should be cumulative and carry a dividend rate of 8%.

Taking into account the representation made by the Company Secretary and the clarification given by Mr. Sawa that infusion of funds (debt and equity as mentioned earlier) will not only help Matix to complete the project but also create value, without which the prospects of recovery of Company's dues looks dim, the Board approved the proposal of Investment into RPS of Matix in one or more tranches by conversion of existing dues of up to Rs. 400 Crores with the following modification in the terms and conditions of RPS:

1. **RPS should be cumulative**
2. **RPS should carry 8% dividend.**

Thereafter, the Board passed the following resolution unanimously:-

"RESOLVED THAT subject to such statutory approvals as may be required, if any and pursuant to the provisions of Section 179, 186 and any other applicable provisions, if any, of the Companies Act, 2013 read with rules made thereunder and subject such consents and approvals, if any, as may be required, the consent of the Board of Directors of the Company be and is hereby accorded to make investment up to Rs. 400 Crores into 8% Cumulative Redeemable Preference Shares of Rs. 10/- each of Matix Fertilizer and Chemicals Limited (Matix) in one or more tranches."

(Emphasis supplied)

7. On 26.08.2015, by letter dated 26.08.2015, the respondent-Matix communicated to the appellant as under: -

"We refer to your e-mail dated July 31, 2015 wherein Essar Projects India Limited Board has approved and accepted for conversion of outstanding receivables from Matix Fertilisers And Chemicals Limited (Matix) to EPIL towards work done under EPC Contract into 8% Cumulative Redeemable preference Shares (CRPS) of Matix The same was also approved by the Board of Matix in Its Board Meeting held on 14th August, 2015 and thereafter, by the Shareholders of Matix in its Extra Ordinary General Meeting held on 26" August, 2015.

Pursuant to the approval of shareholders Matix Board in its meeting held on 26th August, 2015 Matix has allotted 25,00,00,000 8% Cumulative Redeemable Preference Shares of Rs 10/- each aggregating to Rs.250,00,00,000 to Essar Projects India Limited on the following terms and conditions.

Sr.	Particulars	Amount Rs.
1	Total Value of CRPS	Rs. 250 Crs (Rs. Two Hundred Fifty Crores)

2	Face Value	Rs. 10 per Share
3	Issue Price	At par (face value)
4	Tranches	Can be issued in one or more tranches
5	Tenor and Redemption	Redeemable at par at the end of 3 years. However, Company at its sole discretion, may redeem CRPS at any time within 3 years from the date of issue.
6	Annual Dividend rate (Cumulative)	8% in first year 8% in second year 8% in third year
7	Transferability	Can be transferred subject to the approval of Board of the Company
8	Listing	Not to be listed
9	Rights	These CRPS carry a preferential rights with respect to- a) Payment of dividend, and b) Repayment in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up.
10	Modification of terms	Can be modified before redemption with mutual discussions and written consent of both the parties.

We request your confirmation by signing as EPILs acceptance to proceed with documentation and other necessary compliances.''

There is no dispute that the appellant accepted this letter and in fact the CRPS came to be issued as proposed hereinabove.

APPELLANT BROUGHT UNDER CIRP :-

8. When matters stood thus, Corporate Insolvency Resolution Process (CIRP) under the IBC was initiated against the appellant on 20.04.2018 and one Shri Abhijit Guhathakurta was appointed as an Interim Resolution Professional and later confirmed as a Resolution Professional (for short "RP"). According to the appellant, a letter was written on 24.08.2018 by respondent Matix to the appellant stating that the respondent has unilaterally adjusted the total liability of CRPS amounting to INR 310 Crores against its purported claim against EPCC. It further appears that Matix filed a revised claim of INR 537.87 Crores before the RP of the appellant-EPCC and the same was rejected. It is stated that rejection was accepted by the respondent and it attained finality.

DEMAND NOTICE BY THE APPELLANT – THROUGH 'RP' – ON MATIX :-

9. At this stage, on 27.10.2018, the appellant through its RP issued a demand notice to the respondent calling upon

payment of INR 632.71 Crores (INR 310 Crores on account of maturity of the CRPS and INR 322.71 crores on account of outstanding receivables). On 07.12.2018, the respondent-Matix, by its letter of 07.12.2018, replied to the demand notice and disputed the demand. It also denied its liability. The appellant obtained permission under Section 33(5) of the IBC from the NCLT, Mumbai for permitting the liquidator (same individual who was earlier the RP) to initiate legal action for recovery against the respondent.

SECTION 7, IBC PROCEEDINGS – AGAINST MATIX:-

10. The appellant filed a Section 7 petition against the respondent in CP (IB) No. 536 of 2022 on account of failure to pay the redemption amount of INR 310 Crores payable on account of maturity of CRPS. The appellant further submits that the financial statements of the respondent showed the liability towards CRPS as "unsecured loan" and "other financial liability". The respondent opposed the petition under Section 7, IBC.

DISMISSAL BY NCLT:-

11. The NCLT, by its order of 29.08.2023, dismissed the Section 7-application of the appellant. The NCLT recorded the following findings:-

> **a)** Section 55 of the Companies Act, 2013 is explicit that if the issuing company is not making profits which are available for dividend or has not raised any equity investments specifically for the purpose of redemption of preference shares, then the preference shares cannot be redeemed.
>
> **b)** The non-redemption of preference shares does not result in preference shareholders becoming creditors or the carrying value of preference shares and dividends becoming a debt.
>
> **c)** The Balance Sheet of 2018-19 to 2020-21 manifests losses incurred and the 4th proviso to Section 123 of the Companies Act 2013 manifestly indicates that no dividend is payable out of losses and unless the CRPS becomes redeemable it cannot be termed as a "debt", much less a financial debt.

PROCEEDINGS BEFORE NCLAT:-

12. The appellant filed an appeal before the NCLAT. The NCLAT, by its judgment of 09.04.2025, dismissed the appeal and held as under: -

> **a)** Preference shares shall be redeemed only out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption.

b) Matix never declared dividend or earned profit to redeem the preferential shares. If the preferential shares allotted to the Appellant could not have been redeemed, no debt became due.

c) The correspondence between the parties which ultimately resulted in approval of resolution by the Board of Directors of the Appellant on 30.07.2015 and allotment. of shares by letter dated 26.08.2015 are evidence of a contract between the parties for allotment of 25,00,00,000 8% Cumulative Redeemable Preference Shares of Rs.10/- each aggregating to Rs.250,00,00,000.

d) When preferential shares were allotted to the Appellant, the shares were towards the capital of the Company and the earlier outstanding amount, which according to the Appellant was foundation of issuance of preferential shares shall come to an end.

CONTENTIONS OF PARTIES:-

13. We have heard Mr. Niranjan Reddy, learned Senior Advocate for the appellant and Mr. Mukul Rohtagi and Mr. Ritin Rai, learned Senior Advocates for the respondent. We have perused the records.

CONTENTIONS OF THE APPELLANT:-

14. Mr. Niranjan Reddy, learned Senior Counsel, primarily contended that the true nature of the transaction in question must be assessed by unveiling the underlying intent,

especially when the structure masked the borrowing arrangement. According to the learned Senior Counsel, the CRPS, in the present case, stricto sensu fulfilled all the ingredients required to constitute a "financial debt", having the "commercial effect of borrowing". According to the learned Senior Counsel, the transaction in question entered into by way of exchange of letters between the parties is a transaction in terms of Section 3(33) of the IBC fulfilling the ingredient of Section 5(8)(f) of the IBC. Learned Senior Counsel submitted that Matix understood the "conversion of receivables" as a "subordinate debt"; that the said proposal was for commercial purpose, i.e., to maintain a Debt-to-Equity ratio for further borrowings and commissioning the fertilizer plant and Matix admittedly committed to repay the aforesaid "Subordinate Debt" upon raising of equity at par within three years, thereby fulfilling the ingredient of "commercial effect of borrowing" with repayment obligations.

15. According to the learned Senior Counsel, the CRPS merely acted as a temporary tool for borrowing, providing Matix "a pause point" under the arrangement entered by way of exchange of emails. Learned Senior Counsel relied on the judgment of the NCLAT in ***Sanjay D Kakade*** vs. ***HDFC Ventures Trustee Company Ltd. and Ors***. dated 24.11.2023 in Company Appeal (AT) (Insol.) No.481/2023, where according to the counsel, the NCLAT delved deeper into the intention of the parties and the underlying transaction to decide the question of existence of financial debt. Learned Senior Counsel also relied on the judgments of this Court in ***Global Credit Capital Ltd and Anr.*** v. ***Sach Marketing Pvt Ltd and Anr.***[1], and ***Pioneer Urban Land and Infrastructure Ltd. and Another*** v. ***Union of India and Others***[2] to contend that an expansive interpretation of the phrase "commercial effect of borrowing" ought to have been placed by the NCLAT.

[1] 2024 SCC OnLine SC 649
[2] (2019) 8 SCC 416

CONTENTIONS OF THE RESPONDENT :-

16. Mr. Mukul Rohtagi and Mr. Ritin Rai, learned Senior Advocates, vehemently countered the submissions of the learned Senior Counsel for the appellant. They contended that under Section 3(37) of the IBC words and expressions used in the IBC but not defined in the Code but defined in the Companies Act, 2013 shall have the meaning assigned to them under the Companies Act.

17. They contended by referring to Section 3(37) of the IBC read with Sections 2(64), 2(55), 2(84), 43, 47 and 55 of the Companies Act, 2013 that preference shares do not constitute debt and preference shareholders are not creditors of the Company. In their submission, preference shares being part of the share capital (and not debt capital), preference shareholders do not have a right to initiate insolvency proceedings against the company under Section 7 IBC which is a right available only with the financial creditors of the company. They further contend that under Section 5(8)(f) of the IBC, preference shares do not constitute a financial debt

as defined. According to their submission, the contention of the appellant that preference shareholders can become a financial creditor runs contrary to the very fabric of the share capital of the Company and would blur the line between shareholders and creditor.

QUESTION FOR CONSIDERATION: -

18. In this factual background, the question that arises for consideration is whether the NCLT and NCLAT were justified in dismissing the application of the appellant under Section 7 of the IBC, after holding that the appellant was not a financial creditor?

ANALYSIS AND FINDINGS: -

REDEEMABLE PREFERENCE SHAREHOLDER NOT A CREDITOR :-

19. The admitted facts are that pursuant to the offer made by Matix to convert the outstanding amount to RPS and pursuant to the acceptance of EPCC by its Board Resolution dated 30.07.2015 approving the proposal of investment in

8% Cumulative Redeemable Preference Shares of Rs.10/- each of "Matix" and pursuant to the receipt of the CRPS, the appellant became a preference shareholder.

20. It is well settled in Company Law that preference shares are part of the company's share capital and the amounts paid up on them are not loans. Dividends are paid on the preference shares when company earns a profit. This is for the reason that if the dividends were paid without profits or in excess of profits made, it would amount to an illegal return of the capital. Amount paid up on preference shares not being loans, they do not qualify as a debt.

21. Section 3(37) of the IBC provides that words and expressions used but not defined in the Code but defined in the Companies Act, 2013 (18 of 2013), shall have the meanings respectively assigned to them in the said Act. Section 2(84) of the Companies Act defines share as:- *"Share" means a share in the share capital of a company and includes stock.*

22. Section 43 of the Companies Act defines the kinds of share capital as under:

> "**43. Kinds of share capital**.—The share capital of a company limited by shares shall be of two kinds, namely:—
>
> (a) equity share capital—
>
> (i) with voting rights; or
>
> (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and
>
> (b) preference share capital:
>
> Provided that nothing contained in this Act shall affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.
>
> *Explanation.*—For the purposes of this section,—
>
> (i) "equity share capital", with reference to any company limited by shares, means all share capital which is not preference share capital;
>
> (ii) "preference share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—
>
> (a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
>
> (b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

(iii) capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

(a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (a) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid."

23. It will be noticed that preference share capital is a kind of share capital. Further, for the purpose of Section 43, preference share capital (and consequently preference shareholder) carry a preferential right with respect to the payment of dividend and in the case of winding up or repayment of capital, a preferential right on the repayment of the amount of the share capital.

24. Section 55 of the Companies Act, 2013 deals with issue and redemption of preference shares and reads as under:-

55. Issue and redemption of preference shares.—(1) No company limited by shares shall, after the

commencement of this Act, issue any preference shares which are irredeemable.

(2) A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed:

Provided that a company may issue preference shares for a period exceeding twenty years for infrastructure projects, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders:

Provided further that—

(a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;

(b) no such shares shall be redeemed unless they are fully paid;

(c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account, and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company; and

(d) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed:

Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(ii) in a case not falling under sub-clause (i) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(3) Where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed:

Provided that the Tribunal shall, while giving approval under this sub-section, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

Explanation.—For the removal of doubts, it is hereby declared that the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the

case may be, a reduction, in the share capital of the company.

(4) The capital redemption reserve account may, notwithstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Explanation.—For the purposes of sub-section (2), the term "infrastructure projects" means the infrastructure projects specified in Schedule VI"

Section 55 except sub-section (3) enforced w.e.f. 1-4-2014

25. Section 55 of the Companies Act stipulates that preference shares shall be redeemed only out of the profits of the company which would be otherwise available for dividends or out the proceeds of the fresh issue of shares made for the purpose of such redemption.

26. The following passage from "A Ramaiya's Guide to the Companies Act" (18th Edition, Volume 1 Page 879), pithily explains the distinguishing features between a preference shareholder and a creditor in the following words:-

"**It must be remembered that a preference shareholder is only a shareholder and cannot as a matter of course claim to exercise the rights of a creditor. Preference shareholders are only shareholders and not in the position of creditors**. They cannot sue for the money due

on the shares undertaken to be redeemed, and cannot, as of right, claim a return of their share money except in a winding-up. In *Lalchand Surana* v. *Hyderabad Vanaspathy Ltd.*, (1990) 68 Com Cases 415 at 419 (AP), where a preference shareholder was denied redemption in spite of maturity, he was not allowed to file a creditor's petition for a winding-up order under s. 433(e) of the 1956 Act. **An unredeemed preference shareholder does not become a creditor**."

(Emphasis supplied)

27. B.P. Jeevan Reddy, J. (as His Lordship then was) in ***Lalchand Surana*** vs. ***M/s Hyderabad Vanaspathy Ltd.***[3] held as under:-

"… …. … The only question is whether, in case of failure of the company to repay the amount due thereunder, such shareholders become "creditors". It is in this context that proviso (a) to sub-section (1) of section 80 becomes relevant. Sub-section (1) of section 80 says that subject to the provisions of the said section, a company limited by shares may, if so, authorised by its articles, issue (i) preference shares which are to be redeemed, or (ii) preference shares which are liable to be redeemed at the option of the company. Proviso (a), however, says that no such shares shall be redeemed except out of the profits of the company, which would otherwise be available for dividend, or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. **This aspect, in my opinion, shows that where redeemable preference shares are issued but not honoured when they are ripe for redemption, the holder of those shares does not automatically assume the character of a "creditor". The reason is that his shares can be redeemed only out of the profits of the company which would otherwise be available for**

[3] [1988 SCC OnLine AP 290]

dividend, or by a fresh issue of shares. This is a limitation which is not applicable to the case of an ordinary creditor. In the face of this position in law, and in the absence of any authority on the subject, I hold that the holders of redeemable preference shares do not and cannot become creditors of the company in case their shares are not redeemed by the company at the appropriate time. They continue to be shareholders, no doubt subject to certain preferential rights mentioned in section 85. If they do not become the creditors of the company, they cannot apply for winding up of the company under section 433(e).''

(Emphasis supplied)

CONCEPTUAL DIFFERENCE BETWEEN 'DEBT' AND 'PREFERENCE SHARES': -

28. Explaining the nuanced distinction between ''debt'' and ''share'' particularly in the context of a ''preference shareholder'', Gower in his ''Principles of Modern Company Law'' (Tenth Edition) at page 1071 has the following to say: -

> ''The line between the holder of a debt instrument and a share is particularly narrow if the contrast is made with a preference shareholder, who is a member of the company, but a member whose share rights may limit the shareholder's dividend to a fixed percentage of the nominal value of the share and give that shareholder no right to participate in surplus assets in a winding-up, and perhaps only limited voting rights. **The main difference between the two in such a case may then be that the dividend on a preference share is not payable unless profits are available for distribution, whereas the debt holder's interest entitlement is not subject to this**

constraint; and that the debt holder will rank before the preference holder in a winding-up. Thus, the legal rules operate with a binary divide between debt and equity, but the accounting rules and general practice leads to the creation of securities whose classification in accordance with this divide is problematic."

(Emphasis supplied)

RELEVANT PROVISIONS OF THE IBC :-

29. This being the legal position, it is also time now to examine the statutory provisions of the IBC to understand the pre-requisites to maintain a petition under Section 7 of the IBC. Section 7 speaks of initiation of Corporate Insolvency Resolution Process by the financial creditor. Section 5(7) of the IBC defines a financial creditor. It reads as under:-

"**5(7)** "financial creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to;"

30. Section 5(8) defines financial debt and it is extracted hereunder: -

"5(8) "financial debt" means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes—

(a) money borrowed against the payment of interest;

(b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;

(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;
(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;
(e) receivables sold or discounted other than any receivables sold on non-recourse basis;
(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;

Explanation.—For the purposes of this sub-clause,—
(i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and
(ii) the expressions, ''allottee'' and ''real estate project'' shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;
(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;
(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause;''

31. Section 3 (11) defines debt as under: -

> "3(11) "debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt;"

32. Section 3(12) defines default, which is a crucial ingredient of Section 7 of the IBC, as under: -

> "3(12) "default" means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the debtor or the corporate debtor, as the case may be;"

33. Section 7(1) and 7(5) of the IBC read thus:-

> **"7. Initiation of corporate insolvency resolution process by financial creditor.**
>
> (1) A financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government, may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred:
>
> xxx xxx
>
> *Explanation*.—For the purposes of this sub-section, a default includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor.
>
> (5) Where the Adjudicating Authority is satisfied that—
>
> (a) a default has occurred and the application under sub-section (2) is complete, and there is no disciplinary proceedings pending against the proposed resolution professional, it may, by order, admit such application; or

(b) default has not occurred or the application under sub-section (2) is incomplete or any disciplinary proceeding is pending against the proposed resolution professional, it may, by order, reject such application:

Provided that the Adjudicating Authority shall, before rejecting the application under clause (b) of sub-section (5), give a notice to the applicant to rectify the defect in his application within seven days of receipt of such notice from the Adjudicating Authority."

34. It will be clear from a plain reading that to maintain a proceeding under Section 7, an application has to be filed by a financial creditor and the application has to be filed when a default has occurred. It will be noticed from the above that for a default "to kick in" there should be non-payment of debt, when whole or any part of the debt has become due and payable and is not paid. Admittedly, the CRPS had not become due and payable since the respondent had not made profits and did not have any reserve out of the profits made in the past nor did it possess any proceeds from a fresh issue of shares made for the purpose of redemption. In this admitted scenario, the question of there being any default under Section 3(12) of the IBC does not arise. Hence, the

argument that the three years period mentioned in the CRPS for redemption having expired, the shares were due for redemption, does not carry the case of the appellant any further.

35. Dealing with the importance of the occurrence of default for the purpose of maintainability of a Section 7-application under the IBC, this Court in ***Innoventive Industries Limited*** vs. ***ICICI Bank and Another***[4], held as under:-

> "28. When it comes to a financial creditor triggering the process, Section 7 becomes relevant. Under the Explanation to Section 7(1), a default is in respect of a financial debt owed to any financial creditor of the corporate debtor — it need not be a debt owed to the applicant financial creditor. Under Section 7(2), an application is to be made under sub-section (1) in such form and manner as is prescribed, which takes us to the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016. Under Rule 4, the application is made by a financial creditor in Form 1 accompanied by documents and records required therein. Form 1 is a detailed form in 5 parts, which requires particulars of the applicant in Part I, particulars of the corporate debtor in Part II, particulars of the proposed interim resolution professional in Part III, particulars of the financial debt in Part IV and documents, records and evidence of default in Part V. Under Rule 4(3), the applicant is to dispatch a copy of the application filed with the adjudicating authority by registered post or speed post to the registered office of the corporate debtor. The speed, within which the adjudicating authority is to ascertain the

[4] (2018) 1 SCC 407

existence of a default from the records of the information utility or on the basis of evidence furnished by the financial creditor, is important. This it must do within 14 days of the receipt of the application. **It is at the stage of Section 7(5), where the adjudicating authority is to be satisfied that a default has occurred, that the corporate debtor is entitled to point out that a default has not occurred in the sense that the "debt", which may also include a disputed claim, is not due. A debt may not be due if it is not payable in law or in fact. The moment the adjudicating authority is satisfied that a default has occurred, the application must be admitted unless it is incomplete, in which case it may give notice to the applicant to rectify the defect within 7 days of receipt of a notice from the adjudicating authority. Under sub-section (7), the adjudicating authority shall then communicate the order passed to the financial creditor and corporate debtor within 7 days of admission or rejection of such application, as the case may be.**"

(Emphasis supplied)

36. That the CRPS were at a stage when the redemption period had expired would not lend greater weight to the case of the appellant. They continue to be preference shareholders and by being preference shareholders they do not enjoy the status of the creditors of the company. Hence, they do not fulfil the definition of a financial creditor for the purpose of Section 7 of the IBC.

37. We are supported by the following holding of this Court in ***Radha Exports (India) Private Limited*** vs. ***K.P. Jayaram and Another***[5]:-

> ”42. The definition of "financial debt" in Section 5(8) makes it clear that "financial debt" means a debt along with interest, if any, disbursed against the consideration for time value of money and would include money raised or borrowed against the payment of interest; amount raised by acceptance under any acceptance credit facility or its dematerialised equivalent, amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument; the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian accounting standards or such other accounting standards as may be prescribed; receivables sold or discounted other than any receivables sold on non-recourse basis or any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing. Explanation to Section 5(8) which relates to real estate projects is of no relevance in the facts and circumstances of this case. **The payment received for shares, duly issued to a third party at the request of the payee as evident from official records, cannot be a debt, not to speak of financial debt.** Shares of a company are transferable subject to restrictions, if any, in its Articles of Association and attract dividend when the company makes profits.”
>
> (Emphasis supplied)

38. The contention of Mr. Niranjan Reddy that the Court has to unveil the underlying intent especially when the outward structure masked the borrowing arrangements is absolutely

[5] (2020) 10 SCC 538

without merit. As the board resolution dated 30.07.2015 clearly indicates, the appellant who before the issuance of CRPS had some receivables due on account of the construction contracts took a conscious call to accept the CRPS. The Board resolution further indicates the following:- "The company secretary explained in detail the terms and conditions of the RPS". She also informed the board that if the proposal is accepted by the board of directors, there will be no outflow of funds from the company and only the outstanding receivables will be converted into RPS. The Board resolution also noticed that the lenders of Matix, the respondent, have agreed to extend additional credit facilities to Matix provided Matix brings in additional equity to such extent as to achieve the debt equity ratio of 2:1 and therefore, by conversion of dues of the company into RPS, Matix will be able to show equity infusion and draw additional credit facilities from the lenders. It is further mentioned in the board resolution that if CRPS is not accepted the prospects of recovery of the dues looked dim.

On this basis CRPS came to be issued for a total value of INR 250 Crores.

39. In view of the issuance of CRPS, the earlier outstanding amount stood extinguished and the nature of relationship of the appellant with the respondent became that of a preference shareholder. There is no question of there being any underlying contrary intent as the only intent was to convert the debt into preferential shareholding. The egg having been scrambled, Mr. Reddy's attempt to unscramble it, must necessarily fail.

40. A Division Bench of the Delhi High Court in ***Commissioner of Income Tax*** vs. ***Rathi Graphics Technologies Limited***,[6] dealing with the extinguishment of the liability of interest in view of the conversion of the same into equity held as under:-

> "16. When pursuant to a settlement the creditor agrees to convert a portion of interest into shares, it must be treated as an extinguishment of liability to pay interest to that extent. In essence there will be no further outstanding interest to that extent. Consequently, the situation where an interest payable on a loan is

[6] 2015 SCC OnLine Del 14470

> converted into shares in the name of the lender/creditor is different from the situation envisaged in Explanation 3C to section 43B of the Act, viz., conversion of interest into "a loan or borrowing". In the latter instance, the liability continues, although in a different form. However, where the interest or a part thereof is converted into equity shares, the said Interest amount for which the conversion is taking place is no longer a liability."

41. There is no merit in the reliance placed on the judgment of the NCLAT in ***Sanjay D Kakade (supra)***. As has been held in the impugned order, the said case turned on the interpretation of the share subscription and the shareholders agreement and documentation available thereon. It was held by the NCLAT that the said case was not a case regarding allocation of shares by payment of money on the basis of which a Section 7-application came to be filed. It was further held that the said case was not a case of simple allotment of shares. NCLAT therein distinguished *Radha Exports (supra)* with the above observations. We are convinced on the perusal of the transaction between the parties in the present case that the appellant as preference shareholder could not have maintained an application under Section 7, IBC.

42. Equally, the reliance placed on ***Global Credit Capital Ltd.*** (supra) and ***Pioneer Urban Land and Infrastructure Ltd.*** (supra) by Mr. Niranjan Reddy, learned Senior Advocate, is not apposite. Applying the real nature of the transaction, the sole irresistible conclusion that is possible is that the appellant being a preference shareholder, is not a creditor and an application by it under Section 7 was not maintainable, as has been rightly held by the authorities below.

ENTRIES IN BOOKS OF ACCOUNTS – NOT DETERMINATIVE:

43. Mr. Niranjan Reddy, learned Senior Counsel, contended that financial debt is an admitted liability in the books of accounts of Matix. This was countered by the learned Senior Counsels for Matix by contending that entries in account books are not determinative of the true nature of the transaction. Accounting Standards (AS 32) prescribe that a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or

determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability. However, the treatment in the accounts due to the prescription of accounting standards will not be determinative of the nature of relationship between the parties as reflected in the documents executed by them. Further the IBC has its own prerequisites which a party needs to fulfil and unless those parameters are met, an application under Section 7 will not pass the initial threshold. Hence, by resort to the treatment in the accounts this case cannot be decided.

44. Emphasizing the significance of the true nature of the transaction, this Court in ***State Bank of India*** vs. ***Commissioner of Income Tax*, Ernakulam**[7] held as under:-

> "11. It was held by this Court in Sutlej Cotton Mills Ltd. v. CIT [(1978) 4 SCC 358 : 1979 SCC (Tax) 22 : (1979) 116 ITR 1] that where profit or loss arose to an assessee on account of appreciation or depreciation in the value of foreign currency held by him, on conversion into another currency, such profit or loss would ordinarily

[7] (1985) 4 SCC 585

be a trading profit or loss if the foreign currency was held by the assessee on revenue account or as a trading asset or as part of circulating capital embarked in the business. But, if on the other hand, the foreign currency was held as a capital asset or as fixed capital, such profit or loss would be of a capital nature.

12. **The important question to be considered is the true nature of the transaction and whether in fact it had resulted in profit or loss to the assessee. In that context it is well settled that the way in which entries are made by the assessee in its books of account is not determinative of the question whether the assessee has earned any profit or suffered any loss.** The assessee might, by making entries which were not in conformity with the proper principles of accountancy, have concealed profit or showed loss and the entries made by him could not, therefore, be regarded as conclusive one way or the other."

(Emphasis supplied)

45. Further, in ***Union of India*** vs. ***Association of Unified Telecom Service Providers of India and Others***,[8] the Court held as under:-

"65. As per Clause 20.4, a licensee must make quarterly payment in the prescribed format as Annexure II showing the computation of revenue and licence fee payable. The format is part of the licence and is independent of accounting standards and is in tune with the definition of gross revenue, and is the basis for the calculation of licence fee. It is only for uniformity that the account has to be maintained as per accounting standards AS-9 which are prescribed from time to time. Once the licensee provides the details to the Government in format Annexure II along with accounts

[8] (2020) 3 SCC 525

certified by the auditor, the reconciliation has to take place. The accounting standard AS-9 is relevant only for whether the figure given by the licensee as to gross revenue is maintained in proper manner once gross revenue is ascertained, then after certain deductions, adjusted gross revenue has to be worked out. **The accounting standard provided in AS-9 cannot override the definition of gross revenue, which is the total revenue for licence and the finding in *Union of India* v. *Assn. of Unified Telecom Service Providers of India*, (2011) 10 SCC 543 in this regard is final, binding and operative.** The accounting standard AS-9 makes it clear that same is in the form of guidelines, it is not comprehensive and does not supersede the practice of accounting. It only lays down a system in which accounts have to be maintained. Accounting standards make it clear that it does not provide for a straitjacket formula for accounting but merely provides for guidelines to maintain the account books in systematic manner.

76. The definition of gross revenue is crystal clear in the agreement. How the adjusted gross revenue to be arrived at is also evident. It cannot be submitted that the revenue has not been defined in the contract. Once the gross revenue is defined, one cannot depart from it and the very meaning is to be given to the revenue for the agreement. Overall revenue, has to be taken into account for determination of licence fees without set off, as provided in the agreement. The same was defined to simplify it to rule out the litigation, disputes and accounting myriads. The submission raised that the term revenue has to be interpreted as the consideration payable in keeping with commercial and financial parlance is what is intended to be avoided. Raising of such submission is a futile attempt that has been made to wriggle out of the definition of gross revenue, which has been held to be binding in the previous judgment in *Union of India* v. *Assn. of Unified Telecom Service Providers of India,* (2011) 10 SCC 543 . **The submission that the contract recognises the applicability of accounting standards, in our opinion, it is only to maintain books of accounts. To a certain extent, it**

cannot be disputed that to have clarity, uniformity and definitiveness; the accounting standards lay down guidelines with respect to financial terms. However, when the financial terms in the agreement are clear in the form of definition of gross revenue governed by Clause 19.1 of the agreement, the definition of Accounting Standard 9 cannot supersede it which is a general one."

(Emphasis supplied)

46. Another important Section in the IBC to be noticed is Section 5(8) which prescribes that to be a financial debt there needs to be disbursal against consideration for the time value of money. Section 5(8)(c) does not talk of preference shares while it talks of note purchase facility, bonds, notes, debentures, loan stock, or any other similar instrument to the categories mentioned thereunder. The omission is significant. As demonstrated above, the paid up money on shares being "share capital" they do not constitute debt.

47. As far as 5(8)(f) is concerned before we deal with the term commercial effect of borrowing the opening clause of 5(8) cannot be lost sight of. It has to be first a debt and such debt would be a financial debt if it is raised under any other

transaction including any forward sale or purchase agreement having the commercial effect of borrowing. As already explained the paid up amounts towards shares do not have the character of debt. The further argument that redemption was due, is also not meritorious. As required under Section 55 of the Companies Act, 2013, the shares could be redeemed only out of the profits or with any amount kept apart for dividends which is not the situation in the present case.

48. This Court in ***Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited*** vs. ***Axis Bank Limited and Others***[9], held as under:-

> "46. Applying the aforementioned fundamental principles to the definition occurring in Section 5(8) of the Code, we have not an iota of doubt that for a debt to become 'financial debt' for the purpose of Part II of the Code, the basic elements are that it ought to be a disbursal against the consideration for time value of money. It may include any of the methods for raising money or incurring liability by the modes prescribed in sub-clauses (a) to (f) of Section 5(8); it may also include any derivative transaction or counter-indemnity obligation as per sub-clauses (g) and (h) of Section 5(8); and it may also be the amount of any liability in respect of any of the guarantee or indemnity for any of the items

[9] (2020) 8 SCC 401

referred to in sub-clauses (a) to (h). **The requirement of existence of a debt, which is disbursed against the consideration for the time value of money, in our view, remains an essential part even in respect of any of the transactions/dealings stated in sub-clauses (a) to (i) of Section 5(8), even if it is not necessarily stated therein.** In any case, the definition, by its very frame, cannot be read so expansive, rather infinitely wide, that the root requirements of 'disbursement' against 'the consideration for the time value of money' could be forsaken in the manner that any transaction could stand alone to become a financial debt. In other words, any of the transactions stated in the said sub-clauses (a) to (i) of Section 5(8) would be falling within the ambit of 'financial debt' only if it carries the essential elements stated in the principal clause or at least has the features which could be traced to such essential elements in the principal clause. In yet other words, the essential element of disbursal, and that too against the consideration for time value of money, needs to be found in the genesis of any debt before it may be treated as 'financial debt' within the meaning of Section 5(8) of the Code. This debt may be of any nature but a part of it is always required to be carrying, or corresponding to, or at least having some traces of disbursal against consideration for the time value of money.

49. Expounding yet further, in our view, the peculiar elements of these expressions ''financial creditor'' and ''financial debt'', as occurring in Sections 5(7) and 5(8), when visualised and compared with the generic expressions ''creditor'' and ''debt'' respectively, as occurring in Sections 3(10) and 3(11) of the Code, the scheme of things envisaged by the Code becomes clearer. The generic term ''creditor'' is defined to mean any person to whom the debt is owed and then, it has also been made clear that it includes a 'financial creditor', a 'secured creditor', an 'unsecured creditor', an 'operational creditor', and a 'decree-holder'. Similarly, a ''debt'' means a liability or obligation in respect of a claim which is due from any person and this

expression has also been given an extended meaning to include a 'financial debt' and an 'operational debt'."

(Emphasis supplied)

49. Further, in ***Global Credit Capital Limited (supra),*** elucidating on the meaning of "financial debt" as defined in Section 5(8), this Court held as under:-

"14. … … The definition incorporates the expression "means and includes". **The first part of the definition, which starts with the word "means", provides that there has to be a debt along with interest, if any, which is disbursed against the consideration for the time value of money. The word "and" appears after the word "money". Before the words "and includes", the legislature has not incorporated a comma. After the word "includes", the legislature has incorporated Categories (a) to (i) of financial debts. Hence, the cases covered by Categories (a) to (i) must satisfy the test laid down by the earlier part of clause (8). The test laid down therein is that there has to be a debt along with interest, if any, and it must be disbursed against the consideration for the time value of money.**

23. Now, coming back to the definition of a financial debt under clause (8) of Section 5 IBC, in the facts of the case, there is no doubt that there is a debt with interest @ 21% p.a. The provision made for interest payment shows that it represents consideration for the time value of money. Now, we come to sub-clause (f) of clause (8) of Section 5 IBC. The first condition of applicability of sub clause (f) is that the amount must be raised under any other transaction. Any other transaction means a transaction which is not covered by sub-clauses (a) to (e). Sub-clause (f) covers all those transactions not covered by any of these sub-clauses of clause (8) that satisfy the test in the first part of Section 8. The condition for the

> applicability of sub-clause (f) is that the transaction must have the commercial effect of borrowing. ‘‘Transaction’’ has been defined in clause (33) of Section 3 IBC, which includes an agreement or arrangement in writing for the transfer of assets, funds, goods, etc. from or to the corporate debtor. In this case, there is an arrangement in writing for the transfer of funds to the corporate debtor. Therefore, the first condition incorporated in sub-clause (f) is fulfilled.
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> (Emphasis supplied)

50. For all these reasons stated above, we find no merit in this appeal. The appeal stands dismissed. No order as to costs.

……J.
[**J. B. PARDIWALA**]

……J.
[**K. V. VISWANATHAN**]

New Delhi;
28th October, 2025