



भारतीय दिवाला और शोधन अक्षमता बोर्ड

Insolvency and Bankruptcy Board of India

19<sup>th</sup> July, 2023

*Subject: Judgment<sup>1</sup> dated 17<sup>th</sup> July, 2023 of the Hon'ble Supreme Court of India in the matter of Paschimanchal Vidyut Vitran Nigam Ltd. Vs. Raman Ispat Private Limited & Ors. [Civil Appeal Nos. 7976 of 2019]*

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## 1. BRIEF FACTS

- In 2010, Paschimanchal Vidyut Vitran Nigam Limited (PVVNL) entered into an agreement with Raman Ispat Private Limited (CD) for supply of electricity. The agreement provided that outstanding electricity dues would constitute a 'charge' on assets of the CD.
- On 12<sup>th</sup> January 2016, PVVNL attached the properties of CD since the electricity dues remained unpaid.
- On 23<sup>rd</sup> January 2016, Tehsildar, Muzaffarnagar restrained transfer of property by sale, donation or any other mode and created a 'charge' on the properties of the CD.
- On 11<sup>th</sup> April 2017, CD got admitted into corporate insolvency resolution process (CIRP) on section 10 application under the Insolvency and Bankruptcy Code, 2016 (Code/IBC).
- On 31<sup>st</sup> January 2018, liquidation order was passed by the Adjudicating Authority (AA).
- On 05<sup>th</sup> March 2018, the District Collector issued notice for recovery of outstanding dues, by auction of movable and immovable properties on default against the final bill dated 27<sup>th</sup> January, 2017.
- On 21<sup>st</sup> August 2018, AA directed District Magistrate and Tehsildar, Muzaffarnagar to immediately release the attached property so as to enable sale of property and distribution in accordance with the Code and held that PVVNL will be an Operational Creditor (OC).
- On 15<sup>th</sup> May 2019, NCLAT dismissed the appeal of PVVNL and declined to interfere with the order of AA.
- Aggrieved by the same, PVVNL approached the Hon'ble Supreme Court.

## 2. ARGUMENTS OF PVVNL

- Sections 173 and 174 of the Electricity Act, 2003 has an overriding effect on all other laws except Consumer Protection Act, 1986; Atomic Energy Act, 1962 and the Railways Act, 1989. A special mechanism for recovery of electricity dues exists in this law. Being special law relating to all aspects of electricity, it has primacy over all other laws including the Code.

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- The rights of electricity suppliers were not subordinate and subject to priority of claims mechanism under the Code.
- It relied on the decision of the Hon'ble Supreme Court in *State Tax Officer Vs. Rainbow Papers Ltd.* (Civil Appeal No. 1661 and 2568 of 2020), in which it was held that by virtue of a security interest created in favour of the Government for tax claims, the tax authorities i.e. the Government, was a secured creditor under the Code.
- Alternatively, the electricity dues are also security interest in favour of PVVNL.

### **3. ARGUMENTS OF THE LIQUIDATOR**

- The Government dues are placed in the waterfall mechanism under section 53(1)(e)(i) of the Code.
- The electricity dues do not enjoy any priority. The creation of charge under a law is a matter of fact which need to be proved. In this case, the statute merely enables recovery of electricity dues as they were recovery of arrears of revenue. This does not result in creation of security interest in favour of PVVNL. Further, such interest was not registered in accordance with section 77 of the Companies Act, 2013 and the IBBI (Liquidation Process) Regulations, 2016.
- IBC is a special law dealing with insolvency and bankruptcy and by virtue of section 238 of IBC, it will prevail over sections 173 and 174 of the Electricity Act, 2003.

### **4. OBSERVATIONS OF THE HON'BLE SUPREME COURT**

#### **4.1. Nuanced approach under IBC for secured creditors**

- The hierarchy or order of priority under section 53 accords Government debts [section 53(1)(e)] and operational debts [section 53(1)(f)] lower priority than dues owed to unsecured financial creditors.
- Debts owed to a secured creditor, whenever such secured creditor “*has relinquished security in the manner set out in section 52*” receive a fairly high priority (immediately after CIRP costs), whereas in other cases, i.e., when the secured creditor does not relinquish security, the priority of claim is lower [section 53(1)(e)(ii)] in respect of “*any amount unpaid following the enforcement of security interest*”.
- Amounts due to the Government (i.e., payable into the Consolidated Fund of India or Consolidated Fund of a State) [section 53(1)(e)(i)] are ranked in the same manner as those of secured creditors who do not relinquish their security interest [section 53(1)(e)(ii)].
- A secured creditor has to take a calculated decision, at the outset of the liquidation process, whether or not to relinquish its secured interest. In case it does so, its dues rank high in the waterfall mechanism. In case it chooses not to relinquish its security interest, and instead proceeds to enforce it without success or is unable to realize all its dues in the process of enforcement, it has to then perforce stand lower in priority, and await distribution of assets upon realization of the liquidation estate, by the liquidator, vis-à-vis the balance of its dues.
- The provisions of the IBC are carefully thought out, and give options to secured creditors, and balance their interests with those of other creditors in a liquidation proceeding.

**4.2. What constitutes ‘government dues’ and whether the dues payable to PVVNL fall under section 53(1)(e)?**

- Considering the Electricity Act, 2003, regulations / code made thereunder and agreement between the parties, a charge was created on the assets of the CD and therefore, PVVNL is a secured operational creditor.
- The expression “*government dues*” is not defined in the Code and it finds place only in the Preamble. What constitutes such dues is spelt out in the waterfall mechanism under section 53(1)(e) – (*any amount due to the Central Government and State Government including amount of Consolidated Fund of India*) and rank lower in priority to the class of creditors described in clauses (a) to (d). Thus, there exists a separate enumeration or specification of the Central Government and State Government dues, as a class apart from other creditors, including creditors who may have secured interest (in respect of which amounts may be payable to them).
- The repeated reference of lowering of priority of debts to the Government, on account of statutory tax or other dues, in the various reports as well as in the Preamble of the Code, means that these dues are distinct and have to be treated as separate from those owed to secured creditors.
- The Central Government and State Government are defined by the General Clauses Act, 1897. The former is defined by section 3(8), and latter by section 3(60). The distinction between the Governments has been recognized and maintained in other decisions of the court.
- The specific mention of other class of creditors whose dues are statutory, such as dues payable to workmen or employees, “*the provident fund, the pension fund, the gratuity fund*” under section 36(4), which excludes these enumerated amounts from the liquidation, especially clarifies that not all dues owed under statute are treated as ‘*government dues*’.
- Dues payable to statutory corporations which do not fall within the description “*amounts due to the central or state government*” such as amounts payable to corporations created by statutes but whose dues do not constitute *government dues* payable or those payable into the respective Consolidated Funds stand on a different footing. Such corporations may be unsecured or secured creditors (FCs or OCs) depending on the nature of the transactions entered into by them with the corporate debtor. On the other hand, dues payable or requiring to be credited to the treasury, such as tax, tariffs, etc. which broadly fall within the ambit of Article 265 of the Constitution are ‘government dues’ and therefore covered by section 53(1)(f) [section 53(1)(e)] of the Code.
- PVVNL undoubtedly has government participation. However, that does not render it a Government or a part of the State Government. Its functions can be replicated by other entities, both private and public. The supply of electricity, the generation, transmission, and distribution of electricity has been liberalized in terms of the Electricity Act, 2003 barring certain segments. Private entities are entitled to hold licenses and private participation as distribution licensees is fairly widespread and accordingly, dues or amounts payable to PVVNL do not fall within section 53(1)(f) [section 53(1)(e)] of the Code.

**4.3. Whether the observations in State Tax Officer Vs. Rainbow Papers Ltd. (Civil Appeal No. 1661 and 2568 of 2020) be relied?**

- Rainbow Papers case did not notice the ‘waterfall mechanism’ under section 53. Furthermore, it was in the context of a resolution process and not during liquidation.
- Section 53 enacts the waterfall mechanism providing for the hierarchy or priority of claims of various classes of creditors. The *government dues* are placed much below those of secured creditors and even unsecured and operational creditors. This design was either not brought to the notice of the court in Rainbow Papers case or was missed altogether. In any event, the judgment has not taken note of the provisions of the Code which treat the dues payable to secured creditors at a higher footing than dues payable to Central or State Government.
- The Gujarat Value Added Tax Act, 2003 no doubt creates a charge in respect of amounts due and payable or arrears. It would be possible to hold [in the absence of a specific enumeration of government dues as in the present case, in section 53(1)(e)] that the State is to be treated as a ‘secured creditor’. However, the separate and distinct treatment of amounts payable to secured creditor on the one hand, and dues payable to the Government on the other clearly signifies Parliament’s intention to treat the latter differently - having lower priority.
- The reliance on *Rainbow Papers case* is of no avail and that judgment has to be confined to the facts of that case alone.

**4.4. Whether IBC overrides the provisions of Electricity Act, 2003?**

- Section 238 of the Code overrides the provisions of the Electricity Act, 2003 despite the latter containing two specific provisions which open with non-obstante clauses (i.e. section 173 and 174).

**4.5. Effect of non-registration of charge**

- Section 77 of the Companies Act, 2013 provides that no charge can be taken into account by the liquidator unless it is duly registered under the said section. Section 78 enacts that when the company whose property is subject to charge fails to register it, the charge holder can seek registration.
- Section 3(31) of the Code defines ‘security interest’ in the widest terms. In view of the concurrent findings of the AA and the NCLAT that PVVNL is a secured creditor, the liquidator cannot urge this aspect at this stage.

The Appeal was dismissed with a direction to the liquidator to decide the claim of PVVNL in the manner required by law.

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