

Lenders, ARCs can exercise voting rights on pledged shares

In **World Crest Advisors LLP v Catalyst Trusteeship Limited & Ors.**¹ (**World Crest-II**), a single judge of the Bombay High Court, Justice R.I. Chagla, has affirmed the rights of lenders and/ or their assignees to be registered as the beneficial owner of pledged shares and to vote on the said shares, upon invocation.

In previous Client Alerts², we analysed (i) the Supreme Court's decision in **PTC India**³, which reinforces the law on pledge over dematerialised shares; and (ii) the judgment of a Division Bench of the Bombay High Court in **World Crest Advisors LLP v Catalyst Trusteeship Limited & Ors.**⁴ (**World Crest-I**), which too affirms lenders' right to vote on pledged shares (and has been passed in appeal proceedings filed in the same suit). In this judgment, the High Court considers both **PTC India** and **World Crest-I**, and sheds light on the rights of pledgee-lenders and pledgee-asset reconstruction companies (**ARCs**) (as assignees of such lenders) under the Indian Contract Act, 1872 (**Contract Act**), the Companies Act, 2013 (**Companies Act**), the Depositories Act, 1996 (**Depositories Act**), the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 (**Depositories Regulations**), and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (**SARFAESI Act**). Key takeaways from the Bombay High Court judgment are summarised herein below.



Contract Act

As held in **PTC India**, a pledge is a form of bailment. This is evident from Section 172 of the Contract Act. As a “subset of bailment”, Sections 148 to 171, 180 and 181 of the Contract Act apply to a pledge. Sections 172 to 179 of the Contract Act do not prohibit parties from contractually agreeing upon additional terms and conditions under their pledge deed, so long as such terms are not in derogation of mandatory provisions of the Contract Act (such as the requirement to provide notice under Section 176). The use of pledged goods by a pledgee, post the invocation of the pledge, but prior to sale (including by way of exercising

¹ 2023 SCC OnLine Bom 1879.

² [Pledge-of-shares.pdf \(cyrilshroff.com\)](#); and [Lenders-right-to-vote-on-pledged-shares.pdf \(cyrilshroff.com\)](#).

³ **PTC India Financial Services Limited v Venkateswarlu Kari & Anr.** 2022 SCC OnLine SC 608.

⁴ 2022 SCC OnLine Bom 1409.

voting rights over the pledged shares), is not barred either under Section 176 or any other provision of the Contract Act. The pledgee has a right to protect the pledged goods and its interest in the pledged goods during the subsistence of the pledge. In this regard, the express terms of the pledge document will prevail and where there are no express terms, the pledgee may hold or assign the pledged goods, until the debt is discharged and cannot be compelled to sell the pledged goods.

Companies Act

As held by the Supreme Court in **LIC v Escorts Ltd.**⁵, only a shareholder listed as a member in the register of members of a company is entitled to exercise voting rights over the shares. Further, as held by the Supreme Court in **Vodafone International Holding BV v Union of India and Anr.**⁶, the right to vote cannot be decoupled from the shares, but voting agreements are valid and enforceable. Such agreements, including the impugned pledge deeds, do not amount to decoupling of voting rights from the shares.

The definition of “beneficial owner” and “member” under Section 2(1)(a) of the Depositories Act and Section 2(55) of the Companies Act cannot be read down to mean a ‘pledgee beneficial owner’, who does not have the full rights of a “member”. There is no context that permits such an interpretation to be placed on the said definitions. Under Section 2(95) of the Companies Act, words that are not defined under the said Act shall have the meaning assigned to them under the Depositories Act. Section 2(2) of the Depositories Act similarly adopts definitions in the Companies Act. Thus, a “beneficial owner” under Section 2(1)(a) of the Depositories Act will be read into the Companies Act and will also be deemed to be a “member” under Section 2(55)(iii) of the Companies Act.

Depositories Act/ Regulations

By mandatorily requiring the depository to register the pledgee as a beneficial owner prior to transferring the pawn held in dematerialised form (as has been held in **PTC India**), the Depositories Act/ Regulations does not curtail or restrict any rights. There are only two categories of owners, “registered owner” - who is necessarily a depository, and “beneficial owner” - in whom all the rights vest. The law does not contemplate different kinds of “beneficial owner”. Thus, it is necessary for a pledgee to be accorded the *status* of “beneficial owner” for the pledgee to exercise its right to sell the pledged dematerialised securities. However, neither the Depositories Act/ Regulations nor the Contract Act limit or restrict the status and right of a “beneficial owner” to only effecting the sale. Thus, upon invocation of the pledge, a pledgee has the right to vote over the pledged dematerialised shares.

SARFAESI Act

Upon invocation, the transfer of the pledged shares, first in the name of the security trustee of the lender, then the lender and finally to the ARC (to whom the lender has assigned its debt), is permissible under the impugned pledge deeds and under law⁷. The definition of “financial asset” under Section 2(l) of the SARFAESI Act includes a pledge of movable property. As has been held by the Delhi High Court in **U.V. Asset Reconstruction Company v. Union of India**⁸, under Section 5(2) of the SARFAESI Act, the ARC, upon acquisition of financial assets and/ or the NPA account of the lender, along with all underlying assets, including pledged shares, is deemed to be the lender (having all rights of the lender) and is recognised as the pledgee. If the pledgor’s contention (to the effect) that Section 5(3) of the SARFAESI Act is not applicable to pledge deeds is accepted, it would render otiose Sections 5(1) and 5(2), read with the definition of “financial asset” under Section 2(l) of the SARFAESI Act, in respect of pledges.

⁵ (1986) 1 SCC 264.

⁶ (2012) 6 SCC 613.

⁷ See **PTC India and Bank of Bihar v. State of Bihar** 1972 3 SCC 196, where it is held that such transfers are not in the nature of a sale.

⁸ 2022 SCC Online Del 4289.

Conclusion

The three decisions in **PTC India, World Crest-I and World Crest-II** fortify lenders' rights to enforce pledged shares. The **World Crest-II** decision is particularly helpful for ARCs as it validates assignment of financial assets with underlying security and enables ARCs to exercise voting rights till the pledged shares are sold.

Cyril Amarchand Mangaldas is acting for J.C. Flowers Asset Reconstruction Private Limited, YES Bank Limited and Catalyst Trusteeship Limited in their dispute with World Crest Advisors LLP and Dish TV India Limited.

Contributors:

L Viswanathan
Partner and Chair – Finance,
Projects and Insolvency
Lviswanathan@cyrilshroff.com

Indranil Deshmukh
Partner (Head - Disputes)
indranil.deshmukh@cyrilshroff.com

Gathi Prakash Karrah
Partner
gathi.prakash@cyrilshroff.com

Disclaimer

All information given in this alert has been compiled from credible, reliable sources. Although reasonable care has been taken to ensure that the information contained in this alert is true and accurate, such information is provided 'as is', without any warranty, express or implied as to the accuracy or completeness of any such information.

Cyril Amarchand Mangaldas shall not be liable for any losses incurred by any person from any use of this publication or its contents. This alert does not constitute legal or any other form of advice from Cyril Amarchand Mangaldas.

Should you have any queries in relation to the alert or on other areas of law, please feel free to contact us on cam.publications@cyrilshroff.com

Cyril Amarchand Mangaldas
Advocates & Solicitors

100⁺ years of legacy

1000 Lawyers

Over 170 Partners

Peninsula Chambers, Peninsula Corporate Park, GK Marg, Lower Parel, Mumbai 400 013, India
T +91 22 2496 4455 E cam.mumbai@cyrilshroff.com W www.cyrilshroff.com
Presence also in Delhi-NCR | Bengaluru | Ahmedabad | Hyderabad | Chennai | GIFT City | Singapore