

Bombay High Court affirms lenders' right to vote on pledged shares : Sequel to Supreme Court decision in PTC India

In a recent pronouncement in the case of **World Crest Advisors LLP vs Catalyst Trusteeship Limited & Ors¹** (**Judgment**), a Division Bench of the Bombay High Court (**High Court**) led by Justice G S Patel has authoritatively ruled that lenders are entitled to voting rights on pledged shares as a matter of contract. The ruling comes soon after the judgment of the Supreme Court in the case of *PTC India Financial Services Pvt. Ltd. v. Venkateswarlu Kari* (**PTC India**)² that considered the question of whether the provisions of the Depositories Act, 1996 (**Depositories Act**) and Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 (**Depositories Regulations**) altered the legal position applicable to pledges under Section 176 and Section 177 of the Indian Contract Act, 1872 (**Contract Act**).

The High Court delivered its judgment whilst considering whether Yes Bank Limited (**Lender**), which is currently the beneficial owner of 26% shares (approx.) (**Shares**) in Dish TV India Limited (**Company**) and for whose benefit the said shares were originally pledged by World Crest Advisors LLP (**Pledgor**) to Catalyst Trusteeship Ltd (**Security Trustee**), is entitled to participate in and/or exercise voting rights, in the Extra-Ordinary General Meeting (**EGM**). Earlier, a Single Judge had declined to restrain the Lender from voting in the EGM.

A few years ago, as security for repayment of loans and credit facilities provided by the Lender, the Pledgor had pledged the Shares, which were in dematerialised form,



to the Security Trustee for the benefit of the Lender. The Pledgor had also agreed that upon invocation of the pledge, the Security Trustee will have the right to transfer the Shares in its own name or in the name of its nominee and in this scenario the Security Trustee will also be entitled to all rights in the Shares including a right to vote in general meetings.

Following default in repayment of the loan by the borrowers, the Security Trustee invoked the pledge on Shares and became the beneficial owners of the Shares. Subsequently, the Security Trustee transferred the Shares in the name of the Lender, thereby making the it the beneficial owner of the Shares.

¹ Delivered on 23rd June 2022 in Commercial Appeal (L) No. 19252 of 2022 in IA (L) No. 17730 of 2022 in Suit (L) No. 29569 of 2021 with IA (L) No. 19253 of 2022

² *PTC India Financial Services Limited v Venkateswarlu Kari and Anr* 2022 SCC OnLine SC 608

Placing reliance on PTC India, the Pledgor moved the High Court on the ground that (i) the transfer of Shares from the Security Trustee to the Lender amounts to a sale-to-self, which has been declared illegal in PTC India; (ii) that parties cannot by contract confer on the pledgee 'general property in Shares, which includes the right to vote since such a contract is contrary to Sections 176 and Section 177 of the Contract Act; and (iii) that PTC India is an authority for the proposition that a pledgee in spite of being a beneficial owner of Shares only has 'special property' in Shares viz. only the right to sell the Shares to a third party and thus, cannot participate and vote at general meetings of the Company.

The High Court rejected the above contentions on the basis of the following:

- a. The Supreme Court in PTC India only restates the long-standing law on pledge and does not rewrite it;
- b. PTC India categorically affirms that the legal principles under Section 176 and Section 177 of the Contract Act apply to pledge of shares in dematerialised form and that the Contract Act, Depositories Act and Depositories Regulations are to be construed harmoniously;
- c. PTC India further affirms that the Depositories Act and the Depositories Regulations, in particular Regulation 58(8) of the Depositories Regulations, deal with the manner in which dematerialised securities can be transferred and sold on the depository and the same are enabling provisions incorporated to facilitate sale of shares through the depository system to third parties;
- d. Regulation 58(8) of the Depositories Regulation does not create any new rights and obligations and/or change the law under Section 176 and Section 177 of the Contract Act;
- e. PTC India does not interpret the transfer to the pledgee/ its nominee as beneficial owner under Regulation 58(8), to be restricted only for the purpose of effecting a future sale. While the pledgor's right of redemption is intact until the sale of the shares to a third party, in the interim there is no restraint on the pledgee and/ or its nominees to exercise all the available rights as the beneficial owner of those shares including voting rights;
- f. Neither the Depositories Act nor the Depositories Regulations envision that pledgees or their nominees, who become beneficial owners of shares, are to be treated as a distinct class of beneficial owners (shareholders) with significantly curtailed rights;
- g. Section 176 and Section 177 of the Contract Act prohibit a sale-to-self and any such sale will amount to conversion. However, a transfer of shares whereby upon invocation of the pledge, the pledgee becomes beneficial owner of the shares and/or a transfer of shares by the pledgee to its nominee whereby the nominee becomes the beneficial owner of shares cannot be regarded as 'sale' and is therefore not inconsistent with Section 176 and Section 177 of the Contract Act; and
- h. PTC India does not hold that parties cannot by contract confer on the pledgee the right to vote and/or any other rights available with the pledgor. PTC India only lays down that parties cannot contract out of a non-derogable mandate under Section 176 or Section 177 of the Contract Act such as the requirement to provide a reasonable notice before a sale or prohibition on sale-to-self.

Conclusion

The unequivocal re-affirmation of voting rights of a pledgee upon invocation of a pledge of dematerialised shares is welcome. The pledgor has the right to redeem the pledge by paying the amount due and short of that a court will not interfere with exercise of rights by the pledgee.

The recent Supreme Court decision and this Bombay High Court decision will advance the value of pledge as collateral for borrowings and will facilitate improvement of credit flow to borrowers who offer shares as collateral.

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