



## JSA Prism Banking and Finance

July 2022

### Bombay High Court upholds a pledgee's right to vote on pledged shares

In a recent judgment passed by the Bombay High Court ("**High Court**") in the matter of *World Crest Advisors LLP v. Catalyst Trusteeship Limited & Ors.*<sup>1</sup>, the High Court has recognised the right of a pledgee/lender (as the nominee or transferee of the pledgee) to exercise its voting rights in respect of pledged shares as a beneficial owner during the continuation of an event of default.

#### Background

1. Yes Bank Limited ("**Lender**") had advanced certain loan facilities ("**Facilities**") to certain borrowers forming part of the Essel Group. Catalyst Trusteeship Limited ("**Pledgee**") had been appointed as the security trustee for the benefit of the Lender. The Facilities were secured by a pledge ("**Pledge**") created in favour of the Pledgee (for the benefit of the Lender) over 44,00,54,852 shares ("**Pledged Shares**") held by World Crest Advisors LLP ("**Pledgor**") in demat form in Dish TV India Limited ("**Dish TV**"). The Pledged Shares constituted approximately 24.19% shares of Dish TV.
2. Certain events of default had occurred under the Facilities pursuant to which the Pledgee had invoked the Pledge and transferred the Pledged Shares in its own demat account. The Pledgee had informed the Pledgor and Dish TV of such invocation. The Pledgee thereafter transferred the Pledged Shares to the demat account of the Lender. The Lender continued to hold the Pledged Shares as security for the Facilities.
3. Subsequently, Dish TV scheduled its 33<sup>rd</sup> annual general meeting ("**AGM**") for December 30, 2021. The Pledgor issued a notice to Dish TV requesting Dish TV to facilitate the Pledgor in exercising its voting rights in respect of the Pledged Shares in the said AGM. In response to the said notice, Dish TV confirmed that only those shareholders can vote who hold the shares in their own custody/demat account.
4. Thereafter, the Pledgor filed a suit before the High Court *inter alia* challenging the transfer of the Pledged Shares by the Pledgee in favour of the Lender. While the suit was being heard, Dish TV's next AGM was proposed to be held on June 24, 2022. In the said suit, the Pledgor filed various interim applications and one of the interim applications ("**Interim Application**") filed was *inter alia* for: (a) restraining the Pledgee and the Lender from participating in the AGM to be held on June 24, 2022 and exercising any rights including voting rights at this meeting; (b) restraining the Pledgee from interfering in or seeking to participate in the management and affairs of Dish TV; and (c) seeking an order saying that it should be allowed to exercise the voting rights in respect of the Pledged Shares.

<sup>1</sup> Interim Application (L) No. 19253 of 2022 in Commercial Suit (L) No. 29569 of 2021

5. The Interim Application was dismissed by a single judge bench of the High Court by an order noting that there was no *prima facie* case for granting an injunction (“**Impugned Order**”) and the same has been appealed before a division bench of the High Court.
6. In the appeal, both the Pledgor and the Pledgee heavily relied upon a judgement which has been recently passed by the Hon’ble Supreme Court in the matter of *PTC India Financial Services Limited v. Venkateswarlu Kari*<sup>2</sup> (“**SC Judgment**”) to support their case. In the context of shares which are held in dematerialised form, the SC Judgment discusses at length the law relating to pledges as laid down under Sections 176 and 177 of the Contract Act, 1872 (“**Contract Act**”) and its interplay with Regulation 58(8) (“**Regulation**”) of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 (“**Depositories Regulations**”)³. The Hon’ble Supreme Court has, while holding that the said provisions of the Contract Act and the Depositories Regulations can be read harmoniously and the Regulation does not have an overwriting effect, also observed the following:
  - (a) As per the Regulation, a pledgee must record itself as a ‘beneficial owner’ before it can proceed to sell the pledged security. This is a mandatory provision. Parties cannot contract out of this provision.
  - (b) Mere transfer in the name of the pledgee as a ‘beneficial owner’ does not amount to actual sale of pledged shares.
  - (c) Where the pledge agreement violated the Regulation, the pledge itself would not become void or illegal; only enforcement of pledge would become unattainable pending compliance with the Regulation.
  - (d) The Regulation has a limited objective and purpose i.e., to ensure that procedural requirements of sale of demat securities are met.
  - (e) The Regulation is not intended to interfere with the freedom to contract consistent with the Contract Act.

### Key issues considered by the Division Bench

The Division Bench of the High Court had to consider the following key issues:

1. Whether the High Court should interfere with the Impugned Order which did not grant an injunction restricting the Pledgee from exercising its voting rights attached to the Pledged Shares.
2. Whether the Pledgee acquires fullness of rights, including voting rights, by transferring the Pledged Shares to its name and act as the “beneficial owner’ for all purposes. Can it further transfer the Pledged Shares to a nominee? Can the Pledgor and the Pledgee enter into a contract which allows the Pledgee to exercise such rights?

### Submissions, findings and decision

#### 1. Relevant provisions of the pledge deeds:

The High Court noted the following provisions of the pledge deeds which were agreed between the Pledgor and the Pledgee:

- (a) The Pledgor as an owner of the Pledged Shares, had pledged all of its rights (including voting rights in or rights to control or direct the affairs of Dish TV), title and interest in the Pledged Shares.
- (b) If an event of default occurs and is continuing, the Pledgee would be entitled to:
  - (i) cause all or any part of the Pledged Shares to be transferred into its name or to the name of its nominee;
  - (ii) exercise any voting rights and any powers or rights which may be exercised by the person in whose

<sup>2</sup> 2022 SCC Online SC 608. JSA represented PTC India Financial Services in this case before the Supreme Court.

<sup>3</sup> Regulation 58(8) of the Depositories Regulations provides for the following:

“(8) Subject to the provisions of the pledge document, the pledgee may invoke the pledge and, on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.”

name the Pledged Shares are registered or who is the holder or bearer of them, to the exclusion of such person.

- (c) Upon the Pledgee exercising its right to vote and sending an intimation thereof to the Pledgor, the Pledgor would have to ensure that, the Pledgee is permitted to attend and exercise the voting rights (including but not limited to e-voting) in respect of the Pledged Shares.
- (d) The Pledgor must not stop or attempt to stop any transfer of the Pledged Shares in favour of and in the name of, the Pledgee or its nominee or in the name of any purchaser.

## 2. Pledgor's key submissions:

- (a) **Transfer of Pledged Shares to Lender:** The Pledgor contended that under the pledge deeds, it is only the Pledgee who can exercise the contractual rights and there is no power available with the Pledgee to make a second stage downstream transfer to the Lender as this would amount to 'sale to self', which is not permissible.
- (b) **Exercise of voting rights:** As per the Contract Act and the SC Judgment, the Lender/Pledgee only has limited or "special rights" in respect of the Pledged Shares i.e., the right to transfer the Pledged Shares to its name but only for the limited purpose of holding it safely until it is redeemed, sold (after notice to the Pledgor) or for the purposes of initiating a recovery suit. A pledgee does not acquire all general property rights in the pledged assets akin to full proprietary, ownership or dispositive rights (including exercise of voting rights) and cannot enter into a contract which recognises such rights.

## 3. Pledgee's key submissions:

- (a) **Rights of a Beneficial Owner and interplay with the SC Judgment:** The Pledgee contended that there is no concept of a 'beneficial owner with restricted rights' under the Companies Act, 2013 or any other applicable law. The SC Judgment also does not create a new or a subsidiary class of members or shareholders who will have diminished or limited rights in respect of Pledged Shares. Transfer of the Pledged Shares in favour of the Lender does not constitute a release of security or 'sale to self'.
- (b) **Parties right to contract:** There is no prohibition in either the Contract Act or under the SC Judgment which prevents the parties from entering into a contract of pledge, where such contract is not inconsistent with their rights under the Contract Act.

## 4. Decision of the High Court:

- (a) The High Court held that the Pledgee/Lender as a beneficial owner does not have severely curtailed rights, especially when its rights can be ended by the Pledgor by exercising its right of redemption.
- (b) The Pledgor's argument that for the intervening period till the Pledged Shares are not sold, the Pledgee cannot exercise any voting rights falls remarkably short on equitable consideration as this could make the security notional and a waste, especially as the Pledgee cannot be compelled to sell the Pledged Shares.
- (c) The High Court also observed that the Pledgor was unable to demonstrate that conferring voting rights to the Pledgee under the pledge deeds equates to transfer of 'general property'. The Pledgor was also unable to demonstrate that even prior to the Regulation coming into effect, no pledgor could contract to give a pledgee voting rights in respect of the pledged shares.
- (d) The High Court ruled that it would not be equitable to allow the Pledgor to not be bound by the terms of the pledge deeds which it has expressly agreed to. It refused to interfere with the Impugned Order rejecting the *ad interim* injunction to restrict the Pledgee's right to vote in the AGM as no overwhelming *prima facie* case had been made by the Pledgor.

## Conclusion and Impact on Pledge Agreements

The High Court has indisputably upheld the right of a pledgee/lender to vote in respect of the pledged shares as a beneficial owner during the continuance of an event of default. The High Court has also relied on and upheld the contractual voting arrangement agreed between a pledgor and a pledgee and as recorded under the pledge agreement. As a corollary, it has now become crucial to ensure that water-tight pledge agreements are entered into, which provide for adequate rights, powers and protections for the pledgee and beneficiaries.

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Our full spectrum of services includes advising clients on corporate debt transactions (including term and working capital debt), acquisition finance, structured finance, project finance, asset finance, real estate finance, trade finance, securitisation, debt capital markets and restructuring and insolvency assignments.

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13 Practices and  
22 Ranked Lawyers



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18 Ranked Lawyers



7 Practices and  
2 Ranked Lawyers



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