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***Can Related Party form part of Committee of
Creditors?***

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16 August 2017**

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Can Related Party form part of Committee of Creditors.

On appointment of the Interim Resolution Professional (“IRP”) by the Hon’ble National Company Law Tribunal (“NCLT”), IRP is required to make the public announcement for collecting the claims from the Creditors of the Corporate Debtors. Once the claims are duly submitted by all the Creditors within the stipulated time as specified in the public announcement, the IRP is required to constitute the Committee of Creditors (“COC”), whereby all the decision-making powers will be transferred from the Board of Directors to COC.

Now the question lies here, whether Related Party to the Corporate Debtors who have the financial debts will form the part of the Committee of Creditors?

“Section 21: Committee of Creditors:

(1) The Interim resolution professional shall after the collection of all claims received against the corporate debtors and determination of the financial position of the corporate debtors, constitute a committee of creditors.

*(2) The committee of creditors shall comprise all financial creditors of the corporate debtor:
“Provided that a related party to whom a corporate debtor owes a financial debt shall have not right of representation, participation or voting in a meeting of the committee of creditors.”*

Referring to Section 21 sub-section (1), the Interim Resolution Professional is required to constitute the Committee of Creditors based on the claims received from the Creditors against the Corporate Debtors. Sub-section (2) refers that all the financial creditors shall comprise the part of Committee of Creditors. The language of both the sub-section is very much clear on the constitution of the COC with all the Financial Creditors, but what in case if any Financial Creditor is also the Related Party to the Corporate Debtors, the same has been explained in the Proviso with the sub-section (2).

Extract of the proviso:

“Provided that a related party to whom a corporate debtor owes a financial debt shall have not right of representation, participation or voting in a meeting of the committee of creditors.”

Referring to the proviso of the above-mentioned section, it clearly prohibits on the representation, participation and voting of the Related Parties in the meeting, however the said proviso does not put any restriction on the related Parties forming a part of the Committee of Creditors. Related Parties can attend the meeting of COC, but they will not have any say in the meeting, they cannot vote for any resolution in the meeting. There is no restriction on the Related Parties in becoming the member of the Committee of Creditors.

Understanding the meaning of each of these words to relate the impact of Related Parties in forming the part of Creditor Committee:

- 1) Representation: Representation to mean that the Related parties will not be allowed to represent any views in the discussion, or that they will not form any opinion in the meeting of the Creditors.
- 2) Participation: Participation here to mean that the Related Parties cannot participate in any discussion or decision making of the Committee. This will restrict the decision making of the Related Parties at the meeting and all the important decision will be taken without their involvement.
- 3) Voting: Voting to conclude that the members attending the meeting will cast their vote, either in the favour of the resolution or against the resolution. But the restriction specify that the Related Parties will not be allowed to cast their vote in the decision making.

However, on referring to Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, which gives the explanation and clarity in detail, where the Regulation 16 gives the explanation in itself about the constitution of the Committee of Creditors, in case if there have been no financial creditors or where all the financial creditors are related parties of the corporate debtors, then who shall become the part of the members in the Committee of Creditors?

As per sub-regulation (2) of Reg. 16, the committee shall consist of the following members:

(a) Eighteen largest operational creditors by value:

Provided that if the number of operational creditors is less than eighteen, the committee shall include all such operational creditors;

*(b) One representative elected by all workmen other than those workmen included under sub-clause (a);
and*

(c) One representative elected by all employee's other than those employees included under sub-clause (a).

The above regulation itself explains the intend of the committee constitution, where the Related Parties are excluded from forming the part of the constitution in totality. Hence, in reference to the said regulation, it is very much clear in understanding the motive and purpose of the committee constitution and exclusion of the Related Parties from the same.

Conclusion:

The background of the above explanation keeping in context with the Regulation 16 of CIRP, it is very much clear about the intention of provision, where the decision-making system in terms of Resolution Process needs to be stringent and that the decision should not be influenced at any cost since, the entire procedure of the Resolution Process can lead to either revival of the company or it may go into liquidation. Hence, the entire decision-making process should be transparent and in the interest of all stakeholders. The entire decision-making authority of the Corporate Debtors gets transferred from the Board of Directors and shareholders to the Committee of Creditors. Hence, the benchmark for the constitution of the committee is very much crucial and it is important for the IRP to note that the decision-making process should be restricted in the interest of the stakeholders.



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