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WORLD CREST JUDGEMENT: BOMBAY HC PROVIDES CLARITY ON RIGHTS OF PLEDGEE VIS-À-VIS PLEDGED SECURITIES

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Background

The Hon'ble Supreme Court in its judgement dated 12 May 2022 in *PTC India Financial Services Limited v Venkateswarlu Kari and Anr*, (Civil Appeal No. 5443 of 2019) (PTC Judgement), provided some much needed clarity on various issues pertaining to the creation and enforcement of pledge created over securities in dematerialised form (Pledged Shares). Particularly, the Supreme Court held that on invocation of pledge, while a pledgee is required to register itself as a beneficial owner of the Pledged Shares in the records of the depository, the pledgee does not have the right to appropriate the Pledged Shares but instead, is required to identify and affect the sale of such Pledged Shares in favour of a third party. Our Ergo update on this judgment can be accessed [here](#).

As a corollary to the aforesaid observation of the Supreme Court, questions arose as to what rights a pledgee is entitled to enjoy in the interim period, i.e., between: (a) the invocation of the dematerialised pledged shares and recording its name as the beneficial owner in the records of the depository; and (b) the sale of the Pledged Shares to a third party. Particularly, whether the pledgee is entitled to exercise voting rights and other consequent rights otherwise available to a beneficial owner of the Pledged Shares.

Recent Judgment of the Bombay High Court

These specific questions came up for consideration before the Hon'ble Bombay High Court (Bombay HC) in the matter of *World Crest Advisors LLP v Catalyst Trusteeship Limited and Ors*¹ (World Crest Judgement) wherein *vide* its order dated 23 June 2022, the Bombay HC held that , if the relevant pledge agreement confers the right on the pledgee to exercise voting rights and appoint a nominee in relation to the Pledged Shares pursuant to the invocation of pledge over such Pledged Shares, then such pledgee would be well within its right to exercise the same and that the PTC Judgment does not have the effect of diluting or negating such rights.

In the World Crest Judgement, the division bench of the Bombay High Court was approached *inter-alia* seeking an ad-interim injunction against the pledgee, Catalyst Trusteeship Limited (acting as the security trustee of Yes Bank Limited (YBL)) (Catalyst) exercising voting rights in the extraordinary general meeting of Dish TV

¹ Interim Application (L) No 19253 of 2022 in Commercial Suit (L) No 29569 of 2021

India Limited (Dish TV) on behalf of World Crest Advisors LLP (World Crest) post the invocation of pledge created over the shares of World Crest in Dish TV in favour of Catalyst.

Submissions by the parties before the Bombay HC

The primary contention presented by World Crest and Dish TV was that the observations of the Supreme Court in the PTC Judgment make it evident that post invocation of a pledge, the pledgee records itself as a beneficial owner of the Pledged Shares for the limited and specific purpose of '*holding them safely*' until they are either redeemed by the pledgor or sold by the pledgee to a third party. Under no circumstances does a pledgee acquire '*general property*' in the Pledged Shares to allow it to *inter-alia* exercise any rights emanating from those shares, such as voting at a general meeting. In other words, post the invocation of pledge over the Pledged Shares, the pledgee only gets '*special property in the pledge*' for the limited purpose of effecting the sale of such Pledged Shares, while the '*general property in the pledge*' remains with the pledgor.

Findings of the Bombay HC

The Bombay HC was not persuaded by the arguments of World Crest and Dish TV. Per contra, the Bombay HC affirmed the submission of YBL that under the provisions of Companies Act, 2013 or the Depositories Act, 1996, the only person who can vote at any general meeting is specifically noted in the statute as being the beneficial owner. Only a beneficial owner is a member of the company. Unlike the case canvassed by World Crest and Dish TV, the PTC Judgment of the does not create a new or a subsidiary class of members or shareholders of the company with significantly diminished rights merely because they are pledgees. The Bombay HC held that once a pledgee becomes a beneficial owner, he can act in all manners as such. As per Sections 47 and 106 of the Companies Act and Section 10(3) of the Depositories Act, **once an entity is shown as a beneficial owner, it is so for all purposes.**

Further, the Bombay HC court noted Clauses 2.1 and 10.3 of the relevant pledge agreement which provided the right to Catalyst to exercise voting rights and appoint a nominee for exercising such rights. On perusing the same, the court refused to restrain YBL (being the nominee of Catalyst and effectively the beneficial owner of the pledged shares) from exercising voting rights in the annual general meeting of Dish TV India Limited. It further held that YBL shall have all the rights attributed to a beneficial owner of the pledged shares including voting rights pursuant to the recording itself as the beneficial owner of the pledged shares under Regulation 58(8) of the SEBI (Depositories and Participants) Regulations, 1996².

Comment

The judgment of the Bombay HC reaffirms that even post the PTC Judgment of the Supreme Court, the standard market practice whereby pledge agreements typically confer the pledgee with the power to attend general meetings and/or vote in relation to the pledged shares pursuant to invocation, remains legal, valid and enforceable. Accordingly, as clarified by the Bombay HC in this judgement, while the Supreme Court in the PTC Judgment mandates sale of the pledged shares to third parties, it does not derogate the right of pledgee either under Section 10(3) of the Depositories Act, 1996 or under the pledge agreements to exercise all rights in relation to pledged shares, including exercising the right to vote in relation to such pledged shares between the date it recorded itself as the beneficial owner of the pledged shares and the date on which it affects the sale of such shares to third parties. Furthermore, it is relevant to note that the Bombay HC held that pursuant to the invocation of pledge over the Pledged Shares, a pledgee is not bound to sell the security. It may either sell the security

² These regulations have now been replaced by SEBI (Depositories and Participants) Regulations, 2018.

or file a suit / proceedings for recovery of its dues. This judgement addresses the issue at hand and provides much needed clarity in relation to the rights available with the pledgee.

- *Rahul Chakraborti (Partner), Ashwiji Ramaiah (Senior Associate) and Saumya Agarwal (Associate)*

For any queries please contact: editors@khaitanco.com

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