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INSOLVENCY & BANKRUPTCY

Supreme Court Clarifies: Redeemable Preference Shareholders Are Not Financial Creditors Under IBC

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Introduction

In a decision shaping the contours of India's insolvency jurisprudence, the Supreme Court of India in EPC Constructions India Limited (Through Its Liquidator) v. Matix Fertilizers and Chemicals Limited[1] clarified that holders of Cumulative Redeemable Preference Shares (CRPS) cannot be treated as financial creditors under the Insolvency and Bankruptcy Code, 2016 (IBC).

The Court decisively held that preference shareholders are investors and not lenders, and their claims for redemption cannot constitute a "financial debt" capable of triggering insolvency proceedings under Section 7 of the IBC. Emphasizing the statutory distinction between share capital and debt, the Bench highlights that the IBC cannot be invoked as a recovery mechanism for equity investments, even if the redemption period for preference shares has expired.

This ruling harmonizes the provisions of the Companies Act, 2013 and the IBC, reinforcing that preference share capital remains part of the company's equity structure until duly redeemed in accordance with Section 55 of the Companies Act and cannot, by default, metamorphose into a debt obligation.

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Background of the Case

The dispute in EPC Constructions India Limited (Through Its Liquidator) v. Matix Fertilizers and Chemicals Limited arose out of a commercial relationship between the two companies dating back to 2009. EPC Constructions India Limited (EPCC), formerly known as Essar Projects (India) Limited, had been engaged by Matix Fertilizers and Chemicals Limited (Matix) to construct a large fertilizer plant in West Bengal. During the course of the project, Matix faced liquidity issues, resulting in delayed payments to EPCC for its engineering and construction services.

To resolve the impasse and maintain project continuity, Matix proposed that the outstanding dues be converted into equity-linked instruments to improve its debt-equity ratio and attract further bank financing. Accepting this proposal, EPCC agreed to convert a portion of its receivables amounting to ?250 crore into 25 crore 8% Cumulative Redeemable Preference Shares (CRPS) of ?10 each, issued by Matix in 2015. These preference shares were redeemable at par after three years, at the discretion of the company.

In 2018, insolvency proceedings were initiated against EPCC itself, and a liquidator was appointed. During the liquidation process, the liquidator raised a claim against Matix for ?310 crore, representing the redemption value of the CRPS along with accrued dividends. When Matix refused to redeem the shares on the ground that it lacked sufficient profits or fresh issue proceeds as required under Section 55 of the Companies Act, 2013 the liquidator filed an application under Section 7 of the Insolvency and Bankruptcy Code, 2016, asserting that Matix had defaulted on a "financial debt."

The National Company Law Tribunal (NCLT), Kolkata Bench, dismissed the petition on 29 August 2023, holding that preference shareholders are not financial creditors under the IBC. The decision was affirmed by the National Company Law Appellate Tribunal (NCLAT) on 9 April 2025. The liquidator of EPCC thereafter approached the Supreme Court of India, contending that the CRPS had the commercial effect of borrowing, and that failure to redeem them amounted to a default within the meaning of the IBC.

This appeal led to the Supreme Court's authoritative interpretation of the legal status of redeemable preference shareholders and their ability or lack thereof to invoke the IBC as financial creditors.

Issues Before the Court

The principal question before the Supreme Court was:

Whether a holder of Cumulative Redeemable Preference Shares (CRPS) can be considered a financial creditor under Section 7 of the IBC?

Supreme Court's Analysis and Findings

1. Preference Shares Are Share Capital, Not Debt

The Court observed that **preference shares** form part of the share capital of a company under **Section 43(b)** of the Companies Act, 2013, and do not constitute loans. A preference shareholder enjoys preferential rights only regarding **dividends** and **repayment of capital** during winding up not creditor rights. Citing A. Ramaiya's Guide[2] to the Companies Act and Lalchand Surana v. Hyderabad Vanaspathy Ltd.[3], the Court reiterated:

"A preference shareholder is only a shareholder and cannot as a matter of course claim to exercise the rights of a creditor. Preference shareholders are only shareholders and not in the position of creditors."

Hence, even if redemption is due, **failure to redeem preference shares does not transform shareholders into creditors**.

2. No Default Under the IBC

Under Sections 3(11), 3(12), and 7 of the IBC, insolvency proceedings can only be triggered when there is a default in repayment of a debt. The Court emphasized that redemption of preference shares under Section 55 of the Companies Act can occur only out of profits available for dividend or proceeds of fresh share issues. Since Matix had no such profits or proceeds, no legally enforceable liability had arisen, and hence no default existed under the IBC.

"Admittedly, the CRPS had not become due and payable since the respondent had not made profits and did not have reserves or proceeds from any fresh issue of shares."

3. The Conversion Extinguished the Original Debt

The Court rejected the appellant's contention that the CRPS masked a borrowing arrangement. Once EPCC voluntarily converted its receivables into shares, its earlier debt claim stood **extinguished**. The transaction was a conscious restructuring decision, not a disguised loan: "The egg having been scrambled, the attempt to unscramble it must necessarily fail."

By accepting CRPS, EPCC became a **preference shareholder** not a creditor and could not claim repayment as a debt.

4. Entries in Books of Account Are Not Determinative

EPCC had argued that Matix's balance sheets classified CRPS as "unsecured loans" or "financial liabilities." The Court dismissed this argument, holding that accounting treatment cannot override the legal nature of a transaction:

"Accounting standards may classify an instrument as a liability, but that does not alter its legal character under company or insolvency law. The true nature of a transaction must be ascertained from its governing documents and statutory provisions, not from nomenclature in balance sheets."

The Court relied on State Bank of India v. CIT[4] and Union of India v. Association of Unified Telecom Service Providers[5], reaffirming that the true nature of a transaction must be discerned from the governing documents, not accounting nomenclature.

Through this reasoning, the Court reiterated that financial reporting practices though reflective of a company's internal assessment cannot substitute for statutory interpretation. What governs the determination of financial debt under the IBC is the substance of the obligation, not the form or label it carries in financial statements.

5. The "Commercial Effect of Borrowing" Clause Not Attracted

The appellant's reliance on Section 5(8)(f) of the IBC covering transactions having the commercial effect of borrowing was also rejected. "The essence of a financial debt lies in the element of borrowing and repayment. Paid-up share capital, even if redeemable, lacks the element of disbursal and time value of money that defines a financial transaction."

Referring to Anuj Jain v. Axis Bank Ltd.[6], the Court reaffirmed that the "commercial effect of borrowing" test applies only to arrangements that functionally resemble loans or credit transactions. Similarly, in Global Credit Capital Ltd. v. Sach Marketing Pvt. Ltd.[7], it had been held that equity or quasi-equity instruments cannot be retrospectively treated as debt merely because redemption or repayment has become due.

Thus, the Supreme Court concluded that the CRPS, being part of the company's share capital, did not possess the essential characteristics of a financial debt namely, disbursement against time value of money and enforceable repayment obligation. The mere expiry of the redemption period, absent statutory prerequisites under Section 55 of the Companies Act, 2013, could not transform a shareholder's investment into a creditor's claim.

Decision Passed

The Supreme Court held that:

- EPCC, as a redeemable preference shareholder, remained an investor and not a financial creditor.
- Non-redemption of preference shares did not constitute default under the IBC.
- The Section 7 application filed by the liquidator of EPCC was not maintainable.

Accordingly, the appeal was dismissed, with no order as to costs.

Conclusion

The Supreme Court's decision in EPC Constructions India Ltd. v. Matix Fertilizers and Chemicals Ltd. reinforces the vital distinction between equity and debt in corporate finance. By holding that redeemable preference shareholders are investors, not lenders, the Court safeguarded the Insolvency and Bankruptcy Code (IBC) from being misused as a recovery tool for equity investments.

The ruling emphasizes that accounting treatment cannot override legal reality, and the "commercial effect of borrowing" under Section 5(8)(f) applies only to genuine debt transactions. This judgment strengthens corporate governance by ensuring that share capital remains equity until lawfully redeemed under the Companies Act, 2013, preserving the sanctity of corporate capital structures and investor discipline.

For more details, write to us at: contact@indialaw.in

[1] Civil Appeal No. 11077 of 2025

[2] 18th Edition, Volume 1 Page 879

[3] (1990) 68 Com Cases 415 at 419 (AP)

[4] (1985) 4 SCC 585

[5] (2020) 3 SCC 525

[6] (2020) 8 SCC 401

[7] 2024 SCC OnLine SC 649

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