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Dooray Paved Doorway

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The Hyderabad Bench of the Adjudicating Authority (AA) comprising learned Members, namely, Mr. Rajeswara Rao Vittanala and Mr. Ravikumar Duraisamy created history on August 2, 2017 when it approved the first resolution plan under the Insolvency and Bankruptcy Code, 2016 (Code) on finding that '*it meets all parameters, including legal and moral*'. While approving the resolution plan, the AA observed: '..*and the Resolution Applicant is from South, Resolution Professional is from East, Banks/financial institutions/EARC are from West and an ARC and most of the counsels are from North, therefore we further observe that Pan India efforts were involved to revive the Corporate Debtor* ..'

The corporate insolvency resolution process (CIRP) yielding the above resolution plan for resolution of the corporate debtor (CD), Synergies Dooray Automotive Limited (Dooray) was conducted under the stewardship of CS Mamta Binani, who incidentally is the first insolvency professional (IP) registered with the Insolvency and Bankruptcy Board of India (IBBI). The run-up to approval of the resolution plan, the onslaught on the Code based on the plan, and the post-approval intense litigations were nothing short of spectacular. The resolution plan, however, came out unscathed. Dooray paved the doorway for thousand others to follow and changed the trajectory of insolvency resolution forever. Dooray saga is now a part of insolvency folklore.

THE RESOLUTION PROCESS

Dooray, which had its registered office in Ameerpet and factory in Vishakhapatnam, was incorporated on June 14, 1995. It had a negative net worth at the end of March, 2004 and consequently was declared a sick company by the Board for Industrial and Financial Reconstruction (BIFR) on February 14, 2007. As on September 30, 2004, Dooray had an outstanding debt of Rs. 212 crore. Some creditors of Dooray assigned their debts constituting a substantial amount of the outstanding debt on the balance sheet to a related party, Synergies Castings Limited (Castings) over 2008-11. Years later, Castings assigned a substantial amount of debt at a discounted consideration to Millennium Finance Limited (MFL), a Non-Banking Financial Company (NBFC), on November 24, 2016.

The Central Government, *vide* notification dated November 25, 2016, appointed December 1, 2016, as the date on which the provisions of the Sick Industrial Companies (Repeal) Act, 2003 shall come into force. Accordingly, any reference made to BIFR, any inquiry pending before BIFR, any appeal preferred to Appellate Authority for Industrial and Financial Reconstruction (AAIFR), or any proceedings pending before BIFR/AAIFR automatically stood abated with effect from December 1, 2016. Dooray applied for CIRP under section 10 of the

Code. The application was admitted and CIRP commenced on January 23, 2017. Dooray had total assets of Rs. 11.95 crore in the books with a liquidation value of Rs. 8.17 crore at the commencement of the CIRP. On the same date, it had an outstanding debt of Rs. 972.15, including interest, as under:

SI. No.	Financial Creditor	Amount of Debt (Rs. crore)		Percentage Share in	
		Before November 24, 2016	After November 24, 2016	Debt	Voting Power
1	Alchemist Asset Reconstruction Company Ltd. (AARC)	122.06	122.06	12.56	13.83
2	Edelweiss Asset Reconstruction Company Ltd. (EARC)	86.92	86.92	8.94	9.84
3	Millennium Finance Limited (MFL)	00.00	673.91	69.32	76.33
4	Synergies Castings Limited (Castings)	763.17	89.26	9.18	0.00
	Total	**972.15**	**972.15**	**100.00**	**100.00**

Three resolution applicants, namely, SMB Ashes Industries, Suiyas Industries Private Limited and Castings submitted resolution plans. The committee of creditors (CoC) unanimously rejected the resolution plans submitted by SMB Ashes Industries and Suiyas Industries Private Limited. It approved the resolution plan submitted by Castings with 90.16 per cent voting share, with certain modifications, in its second meeting on June 24, 2017. The minority creditor, EARC abstained from voting. The AA approved the plan on August 2, 2017. The plan provided for amalgamation of the Dooray with Castings, a related party with effect from March 31, 2017. It provided for similar treatment to all financial creditors (FC), whether they voted in favour of the plan or abstained from voting. It provided for realisations by claimants as under:

SI. No.	Claimant	Amount of Claim (Rs. lakh)	
		Admitted	Realisations (Over time)
1	Insolvency resolution process cost	NA	50.00
2	Financial Creditors	**97215**	**5469.68**
2(a)	Alchemist Asset Reconstruction Company Ltd. (AARC)	12206	686.77
2(b)	Edelweiss Asset Reconstruction Company Ltd. (EARC)	8692	489.00
2(c)	Millennium Finance Limited (MFL)	67391	3791.75
2(d)	Synergies Castings Limited (Castings) (Notional being resolution applicant))	8926	502.16
3	Deferred Sales Tax	NA	351.69
4	Current Liabilities	NA	1.16
5	Statutory Dues	NA	43.13
6	Shareholders	NA	93,275 shares of face value of Rs.10 each, accounting for 0.37 per cent of shares of Castings.

DOORAY SAGA

The Code kicked in with no precedents to fall back upon. There were no formats and practices to rely on nor was there any experience with any of the constituents of the insolvency ecosystem. Elements, namely, IBBI, IPs, AA, CoC, resolution applicants were as new as the enactment itself. They dealt with the matter for the first time, while the corporate world and its stakeholders had only begun reading about the new enactment. However, at stake was the future of Dooray and its stakeholders, including 1800 employees, and the credibility of the Code in resolving corporate insolvencies.

Throughout the CIRP, several applications were made to the AA under section 60(5)(c) of the Code raising contentious issues. The AA disposed each such application of. Several acts of omission and commission of the Resolution Professional (RP) were also challenged. The AA, however, found that the RP had acted strictly in accordance with law and followed the extant procedure and principles of natural justice. Despite these, the CoC approved resolution plan in about 150 days and the AA approved the resolution plan in about 190 days of the commencement of the CIRP. This seemed nothing short of a miracle, when similar cases under the erstwhile regime took ages to conclude. The cost of resolution was under one percent of realisation.

Realisations by Creditors

The FCs realised less than six percent of their claims under the resolution plan. It set the alarm bells ringing. It was argued that if the very first resolution plan was any indication, the banks should just write off the non-performing assets (NPAs) rather than realise only about six per cent after a '*tortuous legal process and fat process costs*'. Or, the Code should be junked. It is, however, important to note that the FCs realised about six times the liquidation value. In the absence of the Code, Dooray would have continued with BIFR for 'n' years more and liquidation value would have depleted further. After 'n' years, Dooray would have been liquidated, which would have returned the liquidation value of Rs. 8.17 crore minus depletion minus cost of liquidation. Consequently, the FCs would have realised less than one percent of their claims, after 'n' years, as against realisation of about six per cent under the resolution plan. More importantly, realisation for FCs was a secondary outcome while the primary outcome was revival of Dooray.

This kind of realisation is consistent with the expectation under the Code in initial days of its implementation. The CIRP yields good outcomes when it is initiated in early days of default and concluded expeditiously. If it is initiated very late, as happened in this case, after decades of sickness, the corporate is only worth its liquidation value, which decays further with time. When that is not done, the CIRP yields either liquidation or abysmal recovery. A few years down the line, CDs would come up for resolution at the earliest instance of default of threshold amount, that is, when they have reasonably good health and hence the outcome then would be good. There have been a few instances where process was initiated in early days of default and the FCs have realised 100 per cent of their claims, in addition to revival of the CD.

Section 29A

In this CIRP, Castings, a related party, took over Dooray, where the FCs took a haircut of about 94 percent. It was argued that the promoters, who drove the CD into the ground, wrested control of the CD through a process under the Code, while the only outcome of the process was haircut for FCs. This was not acceptable that the Code would reward unscrupulous persons at the expense of creditors. The Code made course correction with promulgation of an Ordinance on November 23, 2017, which inserted section 29A to prohibit certain persons from submitting resolution plans, who on account of their antecedents, may adversely impact the credibility of the process under the Code. This ensured that only capable and credible people take control of the CD in the interest of sustainable resolution.

While replying to the debate on the Insolvency and Bankruptcy Code (Amendment) Bill, 2017 in Lok Sabha,[1] the Finance Minister stated:

> 'In the case of resolution also, all type of creditors may take some haircut and the man who created the insolvency pays a fraction of the amount and comes back into management. Should we allow that to continue? The overwhelming view, as expressed by the Members, is that it should not be allowed. This was a gap which was there in the original Bill and by binging in 29A we have tried to fill in that gap. That is the objective. In order that this provision must apply to all existing cases of resolution which are pending, that is the case for urgency. If we had not done this, then all such defaulters would have rejoiced because they would have merrily walked back into these companies by paying only a fraction of these amounts. That is something which besides being commercially imprudent would also be morally unacceptable. That is the real rationale behind this particular Bill.'

Section 29A did not prohibit promoters as such. It prohibited any person, who does not have a credible track record, from submitting a resolution plan. Consequently, the existing promoter and management stood to lose the CD for ever if they suffered from any of the disabilities under section 29A. Since then, the debtors have been begging, borrowing, and stealing to settle the default prior to filing of applications for initiation of CIRP or admission of the application by the AA or restructuring the debt at the earliest sign of default, which helps in preservation of value. The Code thus brought in significant behavioural changes and thereby redefined the debtor-creditor relationship. The defaulter's paradise was lost.[2]

Related Party

A substantial amount of outstanding debt was assigned by Castings, a related party, to a third party NBFC, MFL, on November 24, 2016, one day before the notification of the SICA (Repeal) Act, 2003. While Castings being a related party was not eligible to be a member of the CoC, MFL found a seat in the CoC with more than 75 per cent of voting share. At that time, the resolution plan required approval by 75 per cent of voting share. If the debt was not assigned, Castings as well as MFL would have remained outside the CoC. It was alleged that the debt was assigned with the ulterior motive of including a related party in the CoC to control the process as well as outcome of the process and, therefore, such assignment was illegal. Therefore, the resolution plan approved by the CoC, which included Castings through MFL having more than 75 per cent of voting share, was in contravention of the Code. The AA dismissed these contentions.

On an appeal, the National Company Law Appellate Tribunal (NCLAT) considered whether assignments made by Castings on November 24, 2016 in favour of MFL were legal. It noted that the appellant was as much an assignee as Castings and MFL and that the three assignments were duly executed with the concerned authorities. It observed that the appellant did not have any locus standi to question the assignments in the insolvency proceedings and MFL, not being a related party, was fully competent to join the CoC.

Amalgamation of Corporate Debtor

The resolution plan provided for amalgamation of Dooray with Castings. It was argued that the Code did not envisage amalgamation, which has the effect of extinguishment of the CD itself.

[1] Lok Sabha. Synopsis of Debates. Proceedings other than Questions and Answers. (December 29, 2017). August 6, 2019. http://loksabhaph.nic.in/Debates/Synopsis.aspx.

[2] *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors.*, (2019) 4 SCC 17.

Further, amalgamation of Dooray with Castings violated sections 230-232 of the Companies Act, 2013 (the Act) and thus, failed to satisfy section 30(2)(e) of the Code. The NCLAT held that there is no question of filing an application before the NCLT under sections 230-232 of the Act, at the stage of filing of the resolution plan as it is not known as to which resolution plan would be approved. It further held that the Code is a Code by itself and section 238 provides over riding effect of it over provisions of other Acts in case of conflict. Therefore, it rejected the argument that merger and amalgamation of the companies cannot be proposed in the resolution plan or such proposal is violative of section 30(2)(e) of the Code.[3] Subsequently, the Insolvency and Bankruptcy Code (Amendment) Act, 2019 has clarified that a resolution plan may provide for restructuring of the CD, including by way of merger, amalgamation and demerger.

Government Dues

The Income Tax Department appealed against the order of the AA approving resolution of Dooray on the ground that the AA has granted huge income tax benefits to Castings without impleading the appellant. The NCLAT considered whether the income tax, value added tax or other statutory dues, such as municipal tax, excise duty, etc., come within the meaning of operational debt and whether the Central Government, the State Government or the legal authority having statutory claim, come within the meaning of operational creditors. It held that operational debt in normal course means a debt arising during the operation of a CD. Only when the CD is operational and remains a going concern, the statutory liability, such as payment of income tax, value added tax etc., will arise. As the income tax, value added tax and other statutory dues arising out of the existing law, arises when the CD is operational, such statutory dues have direct nexus with operation of the CD. Therefore, all statutory dues, including income tax, value added tax, etc. come within the meaning of operational debt. Consequently, Income-tax Department of the Central Government and the Sales Tax Department(s) of the State Governments and local authority, who are entitled to dues arising out of the existing laws, are operational creditors.[4] A resolution plan, which settles dues of the creditors, should be binding on Government. There were instances where Government followed up for the balance dues after approval of resolution plan which created uncertainty and discouraging potential resolution applicants. The Insolvency and Bankruptcy Code (Amendment) Act, 2019 makes resolution plan binding on Central Government, any State Government or any local authority to whom the CD owes debt under any law.

CONCLUSION

The CIRP of Dooray served as the laboratory for evolution of best practices and as the school for every IP and other elements of the ecosystem. It was one of the most fiercely litigated CIRP which settled several issues and paved the doorway for many CIRPs in future. It engendered amendments in the Code in 2017 preventing undeserving persons from taking over CD through a CIRP, which in a sense is another dimension of *Swachh* India. It engendered amendments in

[3] *Edelweiss Asset Reconstruction Company Ltd. Vs. Synergies Dooray Automotive Ltd. & Ors.* [CA (AT) Nos. 169 to 173-2018].

[4] *Pr. Director General of Income Tax & Anr. Vs. M/s Synergies Dooray Automotive Ltd. & Ors.* [CA (AT) (Insolvency) No. 205/2017 and connected matters]

the Code in 2019 clarifying the scope of resolution plan and making resolution plan binding on Government. A successful experiment of an economic legislation with far-reaching ramifications, it reinforced rule of law and the notion that institutions do matter.

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